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OTEX - Q4 2017 Open Text Corp Earnings Call

EVENT DATE/TIME: AUGUST 03, 2017 / 9:00PM GMT

OVERVIEW:

Co. reported 4Q17 total revenue of $664m, GAAP net income of $46m or $0.17 per diluted share.

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PRESENTATION

Operator

Welcome to the OpenText Corporation Fourth Quarter and Year End 2017 Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded.(Operator Instructions.)

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

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

Thank you, operator, and good afternoon, everyone. On the call today is OpenText Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea, and our Chief Financial Officer, John Doolittle. We have some prepared remarks, which will be followed by a question-and-answer session.

I'd like to take a moment and 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 and assumptions were applied in drawing any such conclusion. 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 as well as risk factors that may project the future performance results of OpenText are contained in OpenText's Form 10-K 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 John.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Okay, Greg, thank you very much. Welcome to the call, everyone. 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 $664 million. Up 37% from last year and $675 million, up 40% on a constant currency basis. Revenue was negatively impacted by 14% due to an acquisition, due to acquisition accounting rules and by 12% due to foreign exchange. Fiscal 2017 total revenue of $2,291 million, up 26% from last year; $2,317, up 27% on a constant currency basis. Total annual recurring revenue, defined as the sum of cloud and customer support revenue, was $471 million, up 35% from last year and $479 million, up 37% on a constant currency basis. Fiscal 2017 total annual recurring revenue of $1,687 million, up 25% from last year, and $1,705 million, up 27% on a constant currency basis.

License revenue for the quarter of $123 million, up 43% from last year, and $126 million, up 46% on a constant currency basis. Fiscal 2017 license revenue of $369 million, up 30% from last year, and $373 million, up 31% on a constant currency basis.

Cloud revenue for the quarter of $184 million, up 17% from last year; and $186 million, up 19% in constant currency. New MCV bookings this quarter were approximately $78 million, up compared to $67 million in the same period last year. Fiscal 2017 cloud revenue of $705 million, up 17% from last year; and $712 million, up 18% on a constant currency basis. Customer support revenue for the quarter of $288 million, up 49% from last year; and $293 million, up 52% in constant currency. Fiscal 2017 customer support revenue of $981 million, up 31% from last year; and $993 million, up 33% on a constant currency basis. Our customer renewal rate was in the low 90s, similar to last year

Professional services and other revenue for the quarter of $69 million, up 43% from last year; $71 million, up 47% in constant currency. Fiscal 2017 professional services and other revenue of $235 million, up 22% from last year; and $239 million, up 24% on a constant currency basis.

Next, the foreign exchange for the quarter. Foreign exchange negatively impacted revenue by $12 million and it had a negative $0.01 impact on adjusted EPS. The negative effect of the $12 million by revenue type is broken down as follows: Customer Support, $5 million; Cloud, $3 million; PS, $2 million; and License, $2 million. Fiscal '17 foreign exchange negatively impacted revenue by $26 million and negatively impacted adjusted EPS by $0.03. The negative effect of $26 million by revenue type is as follows: customers for $12 million; cloud, $6 million; PS, $4 million; and license, $4 million.

Now the gross margins for the quarter. They were as follows. License margin was 97%, up from 96% last year. Cloud was 57% compared to 59% last year, down primarily due to recent acquisitions. Customer support margin was 88%, up compared to 87% last year. Professional services margin was 15%, up slightly compared to 14% of last year. And I expect to see improvement during fiscal '18 as ECD Professional Services aligns with our fiscal 2018 target model.

Adjusted operating income and margin was $220 million this quarter, up 39%. And adjusted operating margin was 33%, up 40 basis points over last year. On a constant currency basis, adjusted operating income was $223 million, up 41%. For fiscal 2017, adjusted operating income was $728 million, up 18%; and adjusted operating margin was 32%, in the middle of our published annual target range compared to 34% last year. And on a constant currency basis, adjusted operating income was $736 million, up 19% compared to last year.

Adjusted EBITDA was $237 million this quarter, up 37%. For fiscal 2017, adjusted EBITDA was $793, million up 18%. And we've added adjusted EBITDA to our external reporting and investor materials, as we believe it is a helpful measure of the long-term success of the OpenText business model.

Adjusted net income increased by 46% to $159 million this quarter. On a constant currency basis, adjusted net income was $162 million, up approximately 48%. And for fiscal 2017, adjusted net income was $518 million, up 20%. And on a constant currency basis, it was $524 million, up 21%.

Interest expense was $32 million in the quarter, which is in line with the estimated run rate we provided in our investor material. And we've updated our fiscal 2018 target model to be in the range of $125 million to $130 million. Adjusted earnings per share for the quarter was $0.60 on a diluted basis compared to $0.45 for the same period last year, up 33% and up 36% on a constant currency basis at $0.61. Adjusted earnings per share for the year, $2.02 per share on a diluted basis compared to $1.77 for the same period last year, up 14% and up 16% on a constant currency basis at $2.05.

GAAP net income for the quarter was $46 million, $0.17 per share on a diluted basis, down compared to $86 million or $0.35 per share on a diluted basis. The decrease in GAAP net income for the quarter was mainly due to an increase in interest expense of $10 million and an increase in tax expense of $53 million, and these increases were partially offset by the increase in other income.

GAAP net income for fiscal 2017 was $1,026 million or $4.01 compared to $284 million or $1.17. The increase was primarily due to a significant tax benefit 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 OpenText Canada and now resides as part of our Canadian based IP portfolio. The increase in net income was offset by an increase in interest expense of $43 million.

Operating cash flow. As mentioned, adjusted EBITDA for fiscal '17 was $793 million, up 18%. Additionally, we saw revenue growth of 26%, and our receivables grew year-over-year by $160 million, while we maintained relatively flat DSOs whilst onboarding acquisitions. Operating cash flow for the quarter was $102 million, down 14% year-over-year, reflecting growth in receivables, higher interest, one-time tax costs associated with the IP migration and one-time costs associated with our fiscal '17 restructuring plan. In terms of the receivables growth, I noted the DSO's above, but the important point is that we had a strong Q4 with an emphasis on June, and these receivables could not be collected in fiscal '17. The good news is that this bodes well for operating cash flows in Q1. Operating cash flow for the year was $439 million, down 16% year-over-year for similar reasons as I noted above.

On the balance sheet, we ended the fiscal year with $443 million of cash and $632 million of deferred revenue. We remain focused on expanding operating cash flows as we head in fiscal 2018. Our net debt-to-EBITDA is slightly above 3x, given the transformative fiscal year we just completed, and we expect that ratio to fall below 3x in fiscal 2018.

Tax--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 update on this front, we have revised the disclosure of estimated aggregate liability in the 10-K to $585 million, up from the previous $575 million, solely related to estimating interest that has accrued. To reiterate, our adjusted tax rate for the quarter was approximately 15% and is expected to be the same for the next fiscal year.

On ECD, ECD delivered on plan, and we are pleased with the overall performance. Total revenues from ECD were $113 million during the quarter, $193 million for the fiscal year, and adjusted operating margin was approximately 19% for the quarter, an increase of approximately 600 basis points over the prior quarter. I remind you that we provided a deferred revenue waterfall table of the one-time total ECD adjustment of $52 million in our IR deck.

The Board of Directors declared a cash dividend of $0.132 per share for shareholders of record on September 1, 2017, payable on September 22, 2017.

Now to the fiscal '18 target model. Fiscal '18 will be a year of operating cash flow growth, margin expansion, and further strengthening our balance sheet. Our adjusted operating margin target for fiscal 2018 is a range of 32% to 35%, and we expect to start at the low end of the range with similar seasonality to fiscal 2017. We are not providing revenue targets today; however, I would like to highlight our proven track record of historical 10-year revenue compounded annual growth rate of approximately 14% and remind all of you of our typical Q1 dynamics.

In terms of recent acquisitions, on July 26 we closed our previously announced acquisition of Covisint, a leading cloud platform for building identity, automotive and Internet of Things applications, approximately $103 million. Over the next fiscal year we expect the revenue run rate from Covisint to be down approximately 25% to 35% from their publicly reported numbers due to the usual purchase price accounting and first-year integration disruptions. We expect minimal revenue in Q1. Covisint will be on our cloud gross margin immediately, but they will not be accretive to the bottom line until the second half of fiscal 2018.

On July 26, 2017, we also announced that we entered into a definitive agreement to acquire Guidance, a leading provider of forensic security solutions, for approximately $240 million. The acquisition is expected to close during the first quarter of fiscal 2018, subject to customary closing conditions.

And with that, I will turn it over to Mark.

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

Thank you, John, and welcome, everyone. I want to speak to three key items today and before we open the call to your questions. Our Q4 and fiscal 2017 highlights, fiscal 2018, and the key barometers for our business. Let me start with some Q4 highlights.

We had solid revenue performance of $664 million, up 37% year-over-year. Annual recurring revenue, or ARR, was $471 million, up 35% year-over-year. ARR is driven by customer satisfaction, business value derived from our software and services, and continuous innovation, resulting in strong renewal rates. ARR is a key barometer of our business as well as AOM and OCF. This is part of our central thesis.

We had 37 deals over $1 million in value--18 in the cloud, 19 on-premise. Average license size was stable at $387,000. New MCV was $78 million, up 16% year-over-year with an average size of $470,000. On our book of business, 25% originated from new customers and 28% was influenced by partners. Geographically, Americas was 60% of our business, EMEA 30%, and APJ 10%. Industries that contributed 10% or more included Services, Financial Services, CPG retail, and Technology. Key customer wins included Deutsche Bundesbank for ECM, Hatch in engineering and construction management, County of Los Angeles, NASA Langley, Panasonic, State of Tennessee, Volkswagen for Analytics, Anthem for CEM and Blue Cross for ID benefit cards and plan statement. These are marquee organizations making key automation decisions leveraging OpenText innovations.

And lastly, it was a record Enterprise World, with an estimated 5,000 attendees, 400 partners, 230 sessions, and 120 customer speakers. We plan on hosting Enterprise World next year in Toronto as well.

As for the full fiscal year, we delivered approximately $2.3 billion in total revenues and we delivered against what we said we were going to do, and that was to increase our pace of acquisitions and deliver double-digit revenue growth across all our revenue lines. We had positive organic growth in fiscal '17. Our annual recurring revenues were $1.69 billion, up 25% year-over-year. Year-over-year as well, we increased our total revenue by $467 million, onboarded 2,000 new employees and expanded our EIM total addressable market to approximately $35 billion, providing a wider aperture for a long-term strategic flexibility and the optionality for the business.

We acquired the enterprise content division of Dell EMC and are now the worldwide leader in content services against IBM. We acquired Recommind and are leading in the discovery market. We also took an unprofitable business here and made that profitable in the first 12 months of operation, sort of demonstrating the power of our M&A model. We acquired HP CEM and HP CCM and strengthened our market position in customer experience management. We are leading the market in B2B supplier networks and closed ANX and recently closed Covisint, extending our B2B leadership against IBM. With Covisint, we have entered the market for the Internet of Things, auto supplier portals as well as digital identity management. We recently announced our intention to acquire Guidance Software, an information forensic company, to strengthen our information platform and discovery offerings.

We ask a lot of our teams, and the key word that comes to mind is leadership. They provided leadership in execution, in their professionals domains and for our customers and for their fellow employees. It is a team dedicated to our purpose as the information company in transforming the digital marketplace.

I also think it is helpful to look at our fiscal 2007 to '15 within historical trends, as it speaks directly to our culture. Over a 10-year period, total revenue CAGR is 14%. Revenue has grown from $596 million to $2.3 billion. Adjusted operating margins have expanded from 22% to 32%. Operating cash flow CAGR is 15%. That's all over a 10-year period.

Over a 5-year period, our ARR CAGR is 21%, where ARR has grown from $657 million to approximately $1.7 billion. Our adjusted EBITDA CAGR is 18%, where adjusted EBITDA has grown from $351 million to $793 million. Our business model scales, and it scales for three basic reasons. First, we acquire within a market thesis of Enterprise Information Management. This market thesis provides a rich pipeline of opportunity, common business models to optimize against, and a cohesive message that we can bring to our customers.

Second, we are disciplined on our approach to M&A, from due diligence, valuation methodology, investment returns and operational execution.

Third, we integrate. We integrate products, sales forces and business operations and practices. I can't see a boundary to our business or our business model.

As we went to our new fiscal year, fiscal 2018, let me make a few macro points. Fiscal 2018 will be a year of operating cash flow growth, as John noted, margin expansion and revenue growth, which will all further strengthen our balance sheet. We expect the second half of fiscal 2018 to be stronger than the first half. Our adjusted operating margin model for fiscal 2018 is a target range of 32% to 35%, and we expect to start at the low end of this range, similar seasonality in 2017. Please recall ECD will be on our margin model in the second half of the year. As John noted, we are not providing revenue targets today. However, I, too, would like to highlight our proven track record of historical 10-year revenue CAGR of 14%. And we expect typical Q1 dynamics as we start a new fiscal year during the summer months in North America and Europe. We are watching macro issues that could affect customer demand in places such as South Africa, Brazil, Middle East, Russia and China. We all read the same headlines. As for our Professional Services business, we are focused on higher value services such as managed services and upgrades around software. And we'll optimize profit over faster revenue growth.

Covisint is now closed. Over the next year we expect the revenue run rate from Covisint to be down approximately 25% to 30% from their publicly reported numbers due to the usual purchase price accounting, or PPA, and the usual first-year integration disruptions. Covisint will be on our cloud gross margin model immediately, and Covisint will not be accretive to earnings until the second half of this fiscal year.

We are modeling minimal Q1 revenues. We expect guidance software to close within the current quarter and we'll provide more detail after closing. And we have a long-term opportunity to continue to improve the operations and margin, to increase automation and improve processes in people-related expenses.

I've used the term intelligent growth in the past, and I'd like to emphasize this term today. We use the word intelligent because it is not growth at all costs. Rather, it is profitable growth. Fiscal '18 will be no exception. If we could only optimize for one thing, that one thing, we would optimize for a margin dollar over a nonprofitable revenue dollar.

Three principles guide us: execution, leadership and predictability. Execution within our business and our business model, leadership with our customers and our products, and predictability in our approach and results. ARR is well aligned to these three principles. Growth initiatives are very granular. I always like to say that growth is granular and it takes time. Our acquisitions give us an opportunity always to rebalance and expand account coverage as we integrate new sales forces into OpenText. We're working closely with global system implementers like Accenture, Tata, Deloitte, E&Y, Capgemini, to expand our sales coverage strategically and cost effectively. And for many of you who were at Enterprise World, you saw them very directly over that week. We have new offerings in cloud managed services. AI and the Internet of Things positions OpenText well in key market trends and customer interest. And we have a large install base to further promote the adoption of key offerings such as upgrading to Release 16, Information Life-cycle Management, or ILM, Customer Experience Management, Discovery and competitive replacements against IBM, Lexmark and others.

In summary, it was a strong Q4 in a transformative fiscal '17. I'm very proud of the team and their accomplishments in a most extraordinary year for the business. For those who attended Enterprise World, you could see their dedication, their professionalism and their commitment first-hand.

The key barometers for our business include annual recurring revenues or ARR, adjusted operating margin or AOM, and operating cash flow, or OCF. Everything feeds these metrics. We are introducing adjusted EBITDA this year, as John noted, as we think it's an important metric and makes it easier to benchmark OpenText to other large software companies.

We believe in intelligent growth. This is leading with M&A-driven revenue growth, complemented with positive organic growth and profitability over a growth at all cost philosophy. Execution, leadership and predictability guides us.

Lastly, leveraging our large install base. We entered fiscal '18 well aligned to customer demand drivers and the beginning of a new product cycle, with offerings such as Release 16, EP2, Magellan in AI, Covisint and IoT in digital identity, and Info Archive and Information Life-cycle Management, TeamSite/Media Management and CEM as well as our discovery solutions. We intend to leverage these opportunities, both through our direct sales force and our partners.

With that, let me open up the call to your questions.

QUESTIONS AND ANSWERS

Operator

[Operator Instructions.] The first question comes from Phillip Huang of Barclays.

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

I was wondering--great to see the progress on the ECD margin expansion. The summary you provide insights, Slide 16 is helpful in terms of what's left to be done. But just trying to get a sense as to whether most of the heavy lifting is now behind us and whether you see any risks to achieving sort of the 600- to 700-basis-point margin improvement over the next couple of quarters. Is it just a matter of process at this point to getting to 30% to 34%?

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

We like Slide 16, because I think it lays out kind of our progress quarter-by-quarter. Now we're very confident in the second half of the fiscal year that ECD will be on the OpenText margin profile. And reflective of that confidence, John and I raised the target model coming into the year to 32% to 35%, as you saw both in the deck and our prepared remarks. And look, it's August and it's 5 months away until the end of the year. And what progress we've made since announcing the acquisition in January. So it's relatively low risk. All our plans are in place. We've already integrated engineering. We've integrated the sales forces. We have some remaining systems and TSA work to do, but all our plans are laid out to complete that work by the end of the fiscal year.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes, I mean, Phil, when you do a deal of this size, an asset deal like that, the heavy lifting is done in the first couple of quarters. And as you know, we had a restructuring plan that we executed in fiscal Q3 and Q4, so that sets us up for the fiscal '18.

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

That's great to hear. So with that sort of, I don't want to say in the bag, but thinking toward--looking forward to cross-selling opportunity, was wondering if you could maybe give us an update on the progress on educating the sales force and maybe the customers on the products for cross-selling and upselling. Thanks.

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

Yes, fair enough. Thanks, Phillip. When I think of our three big drivers for both acquisition and organic growth, we're quite focused on competitive replacements, specifically against IBM and Lexmark. Two is leveraging the install base, and that means cross-selling. We've selected a couple of key product--a few key products offerings such as Information Life-cycle Management, Customer Experience Management and our SAP solutions as well as bringing a handful of new offerings to market such as Magellan and AI. And then third is continue to scale cost effectively, not just through our direct sales force, but also our partnerships with Global System Implementers.

So the sales forces are integrated. We entered the fiscal year well aligned, and they're trained. Now they have to go out and, of course, learn by doing and build that experience deal by deal through the year. But we come into the year well aligned and well educated.

Operator

The next question comes from Richard Tse, National Bank Financial.

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

At Enterprise World, there's certainly a lot of fanfare around Magellan. There seemed to be a tremendous amount of interest. I was wondering, given that's probably one of the most interesting product releases you guys have had in a few years, what was the post-event feedback that you received on that product release here?

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

Look, we're excited about Magellan and we--there are, I think, three fundamental things. The first is we have some market permission at OpenText, given we've been automating for 20 years some of the world's largest data archives and turning those archives into active information lakes by unlocking customer value through algorithms and visualization, and the world called that AI. And the feedback on that was just very positive coming out of Enterprise World.

Second, our approach compared to Watson is we're taking an open approach and they're taking a closed approach.

And I'd say the third thing that I'm hearing back is the ease of use and the affordability of our solution. So it's been very solid feedback. It's still early days. I want to kind of marry that excitement, both with we're not ready to put Magellan into our financial model at this point and we're going to continue to monitor our first sales cycles and first wins. But the early returns are a lot of excitement from our employees and our customers. But we're not quite ready to put it into our financial model.

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

Okay. On that note, in terms of the financial model, could you maybe sort of give us some broad strokes to help us frame what the addressable market size would be within the OpenText space? Like is it something that will carry across the entire customer base? Just to kind of give us a sense of how big that could be.

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

Well, I think it's going to be applicable to every customer eventually. Again, I'll emphasize that we're not ready to kind of set any financial expectations or put this in our financial model. But I think it's going to be broadly applicable into our install base. It clearly--it's interesting to our business network customers who are looking for a supplier in trading grid algorithms and optimization. It's going to be applicable to Customer Experience Management and algorithms and insights around customers and Content Analytics to both Documentum as well as Content Suite customers. So it's going to be broadly applicable into our enterprise install base.

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

And just the last one for me. On ECD, you've had that asset for a little bit of time now. Can you maybe give us an update whether there have been any surprises in terms of both the opportunities and the challenges? And I'll leave it at that. Thank you.

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

Yes, thanks, Richard. I'll kind of give my views and John as well. I'd say on the upside, I'm really impressed with the expertise and the talent in the organization and the vibrancy. On the product side, Information Life-cycle Management is just a gem that we're going to be able to bring across our entire install base. And as in all asset deals, they take time. I mean, you get a surprise here and there on a legal structure or lease in this country. And you thought you knew it inside and out, so just on the operational side, you always get a surprise or two on an asset deal. But the strength of our corporate development and operations is we've--we know how to power through them and get things done very well.

So the people, the importance of the technology, a gem in information life cycle management, and there's always a surprise or two in an asset deal. John, anything?

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Just to emphasize the people. That's the thing that I take away--the quality of the team.

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

Yes, for sure.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

The attitude. They fit right in. A number of the ECD folks on our leadership level now, and really contributing and bought into the acquisition, Richard.

Operator

The next question comes from Paul Steep of Scotia Capital.

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

Mark, I guess you've held true to your words post when we last met last month, and you've continued to be busy on M&A. Can you give us context around how we should think about the pace of M&A here, given the integration process as well as maybe the comments around the shelf filing as well tonight?

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

Yes, sure thing. So look, our M&A strategy just remains consistent and constant. It's the best way to say it. We have our work over the next 5 months to complete what we've started to get ECD on our operating model, and we're very confident of that. Covisint is now completed, and I've actually gone out and seen my first customers on Covisint over the last week. And it's not just the Internet of Things or auto supplier portals. I think one of the interesting gems in here is Digital Identity Management. But everyone can read their P&L, right? And when we have work to do, as we noted, and that's work we know we need to do, I won't comment on Guidance at this point other than we're obviously excited to get that completed in due course and with normal closing conditions.

So for M&A, it's just going to be constant and consistent. I'll kind of, with the context of intelligent growth. And on the shelf, it's normal course filing just as we refresh the shelf. John, is there anything...

John Doolittle - *Open Text Corporation - Executive VP & CFO*

No, that's what I was just going to say. But Paul, just a really simple refresh. The U.S. shelf needed to be refreshed from a time line point of view, and we just took the opportunity to refresh the Canadian one as well. So very simple and straightforward.

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

So no change to our approach in M&A and we're going to remain consistent to our previous practices.

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

Okay. On the cloud transition, I guess you made a few changes to the operating model here and going forward. Maybe talk about like has anything changed in the market or is this just merely you incorporating and working through the numbers from the various acquisitions? And I've got one quick follow-up for John.

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

Yes, Paul, I'm not sure what you mean by a change. Maybe you're seeing something or hearing something...

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Are you talking margins or?

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

Yes. No, I was talking the revenue mix model at the top of the model, that you shifted things around a little bit as well as the 2020 move on the goal on recurring. I know you--recognizing you stripped out the professional services number.

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

Maybe just a comment on annual or recurring. Over the previous years, we had PS in that number. And we took PS out because we just thought it would be easier benchmark cloud and maintenance, if you will, in ARR. So it's easier for you to do your benchmarks of us against other businesses.

On the PS side, look, we've always gone for the high-value dollar. And that consists of managed services, it consists of working with our, with OpenText customers for new installations, upgrades and new application development. Some PS over time has also migrated into the cloud line as things have gone more to managed services. So I think the ARR is more of a pure industry definition. It will help you benchmark us better. On the PS side, we're continuing to go after those high-value dollars. John, on the model?

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes, I was just going to say, so Paul, just on the mix issue that you allude to, as you well know, we brought in ECD. The cloud business within ECD was not nearly as significant as within OpenText, and that's a real opportunity for us to build. But there's just a realization that when we get the full benefit of ECD, it kind of changes the mix of cloud versus the rest of the line items.

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

And just a last quick one for you, John. If you had it, the Q3 to Q4, if you had the actual impact from that Dell-EMC-TSA that would let us do it on an apples-to-apples basis, that would be helpful. So thanks.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes, Paul other than to say that the TSA rolls off through the year, as we mentioned last time. And we built that, and we will take on that within OpenText. And we've built that into our operating model. So I don't have the actual TSA numbers quarter-over-quarter, but it will be sliding scale downwards.

Operator

The next question comes from Thanos Moschopoulos of BMO Capital Markets.

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

It seems like there was some good momentum with large sales this quarter, certainly a good uptick in million-dollar deals and average deal sizes. Is that partly a ECD impact, or is that reflective of clients buying more modules across the suite as part of their deployments?

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

I think it partly reflected the seasonality of our business. It was our Q4. Also, we--I think it's part of the strength of some of our offerings as well. So I would--but I'd probably point a little more just to the seasonality of the business, given it was Q4.

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

I guess on a year-over-year basis, it was still quite a notable uptick in million-dollar deals. I mean, even more of an increase than the revenue increase would imply, which is why I was asking about that trend.

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

Yes, I'm not ready to draw a trend line. We executed well within the quarter and within Q4.

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

Fair enough. And then on the ECD revenues, you've guided for a 5% to 10% decline at the time of acquisition. And looking at the numbers this quarter, it seems like it may have been a bit more than that if I adjust for the acquisition accounting. And I realize there can be some quarterly volatility. But overall, would you say that the revenues are tracking in line with your initial expectations?

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

Yes, we would.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes, they are. They're on our plan, for sure.

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

Okay. And then finally, Mark, can you give us an update on the competitive environment post ECD? One thing I've been hearing in particular is that there's been an uptick in terms of customers migrating from IBM FileNets to Content Suites. Is that something you're seeing as well? Then more broadly, how would you describe the landscape post ECD?

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

I have the organization focused on IBM, no doubt. And when we bring Documentum into the organization and we look at what we can do versus a FileNet, it's very clear. Our ERP integrations, notably SAP and Oracle, differentiates us against IBM's FileNet. Our Information Life-cycle Management, our Discovery solution, integration to Microsoft such as Office 365, gives customers a real strong choice in the marketplace, and I think a compelling choice. And we had particular wins in this area--U.S. Steel, Southern Edison, VW and GDPR. When we look at our B2B network offerings against Sterling Commerce, there's a variety of things that we can just clearly offer that IBM can't, whether that be in ISO, Swift, or HIPAA sort of compliance areas, product catalogues. We have a whole list. And we won Costco last quarter versus IBM Sterling Commerce.

On the analytic side, we say AI, but we should expand that to include analytics and AI and put Cognos in that category as well against Watson. And we had a couple of nice wins against Cognos in Barclays and Vertex. And on the CEM side, Anthem. Anthem is a nice win against the cacophony of offerings from IBM on CEM, where at Anthem we're going to do unified communications to 74 million folks subscribed to Anthem.

So yes, we have the organization very focused on IBM--very factually, not emotionally--across FileNet, Sterling Commerce, Watson, Cognos, and CEM, and focused on those differentiators, and we had some real nice wins.

Operator

The next question comes from Stephanie Price of CIBC.

Stephanie Doris Price - *CIBC World Markets Inc., Research Division - Analyst*

Can you give us an update on the partner network post recent acquisitions? You mentioned it, I think, in your prepared remarks. Where have you added some strength, just given the recent deals?

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

Yes, a very specific question, but I'd point to new partners such as Cerner in healthcare. I would look towards TCF, Tata, as a very good example. Tech Mahindra with Covisint, Cisco with Covisint would be four examples, Stephanie.

Stephanie Doris Price - *CIBC World Markets Inc., Research Division - Analyst*

And in terms of your operating margin target, can you talk about the puts and takes of what would put you at kind of the higher end versus the lower end of the target?

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Well, Stephanie, a big part of this is the ECD integration. And as we talk about, we made 600 basis points in improvements. We're on top to deliver within 12 months ECD under our operating model. So that's a big part of growing the operating margin.

And of course, I'll point to the restructuring that we executed in Q3 and Q4 as well, which really positions us well from an operating margin point of view in fiscal '18. So I'm not going to give you whether we're going to end up at the 32% or the 35%, but we've kind of given you color in terms of where we think we're going to go throughout the year.

Stephanie Doris Price - *CIBC World Markets Inc., Research Division - Analyst*

Fair enough. And then maybe just a final...

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

If I could just jump in--and John, correct me if I have it wrong--but numbers aside for a moment. If we look where kind of how we execute in '16 from '17, it's completing acquisition integrations and then continuing with our automation and labor placement, if you will, around the world. Those are the three big levers.

Stephanie Doris Price - *CIBC World Markets Inc., Research Division - Analyst*

And then just finally on cross-selling. You touched on it earlier, but I was wondering if you could talk a little bit about how the sales team is incented to cross-sell and any wins that you've seen recently.

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

We don't--at OpenText--I think I said--I know I've said this before, maybe not recently. We don't put product line quotas out there in the field. We just don't believe in them. It's hard for me to take a rep in Toulouse, France, and know what products are best to sell in Toulouse, France, as an example. So they get an overall quota number.

But we get to emphasize, via training and through materials and corporate resources, what's available for them and the tools available to them. So we do that through influence and education versus through specific quota systems. And we've picked a handful--Information Life-cycle Management, CEM, SAP solutions and Discovery. Those are the solutions we're looking to have the field very, very focused on. We had a large U.S. transportation company, as an example, that was just a clear win from that reseller effort. I think Southern Edison would be another good example of some of those efforts as well.

Operator

The next question comes from Steven Li of Raymond James.

Steven Li - *Raymond James Ltd., Research Division - SVP*

A couple of questions for me. Mark, at a high level, can you maybe talk about Guidance Software and how it fits with your eDiscovery and Recommind? Is there any overlapping functionalities or opportunities to cross-sell?

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

Yes, so I'd say there are two main pieces here. The first is their discovery solution, which is EnCase, which is really discovery at the endpoint. What Recommind does very well is once the data comes back centralized, trying to go through 10 million documents and trying to find the needle in the haystack, so that ability to do the analytics, finding that key piece of information is a big strength of Recommind.

What Guidance does is on the endpoint, endpoint discovery called EnCase. So it's completely complementary to the discovery. Imagine having 10,000 laptops and having to collect data from those 10,000 laptops to come back to Recommind. I think the second thing that Guidance, we're interested in from a go-to-market and technology, is having that technology in some of the newer products around information forensics and providing insights into cyber as well as to the forensics of the information. So complementary to discovery and new data forensics opportunity.

Steven Li - *Raymond James Ltd., Research Division - SVP*

And then I have a partner question for you, Mark. So I saw your partner revenue as a percentage drop with Documentum the last 2 quarters. Is this an anomaly or is it actually an opportunity going forward, given your earlier comments?

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

Yes. I haven't been--it hasn't hit my radar that the channel, the influenced number from partners is varying because of an acquisition. I'll go look at that a little more closely. I can tell you, certainly, that the interest from the global system implementers are very strong in our number. So I don't see any anomalies or any change in behaviors. So I guess it might be an opportunity, then.

Steven Li - *Raymond James Ltd., Research Division - SVP*

And a quick one for John. For your cash flow from ops, you talked about a couple of one-time items. Can you go through those again and maybe try to quantify them? Thanks.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes, sure, Steven. So first of all and most important is accounts receivable. So you'll take a look at the K and you'll see tat receivables grew from the third quarter to the fourth quarter by about $85 million. And that's purely a function of a very good fourth quarter and a very busy June. And so as a consequence of that, it's very difficult to collect receivables for sales in the month of June. So that's Number 1.

Number 2 is our interest expense or interest cash cost is up, and that's no surprise. Fiscal '17 was a year of investment and we haven't realized the full benefits of those investments yet, so interest expense is another component.

And there were some one-time tax costs related to the IP migration. And I don't have the exact number on that, but approximately $25 million is probably the right ballpark for that. So those really are the three things with an emphasis on receivables.

Steven Li - *Raymond James Ltd., Research Division - SVP*

And that $25 million, that's for the whole year, right?

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Yes.

Operator

The next question comes from Paul Treiber of RBC Capital Markets.

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

Just a couple of questions on M&A. I think the acquisitions of Covisint and Guidance probably came sooner than most would have expected, just in light of ECD and the size of it. Just what's your thoughts on M&A capacity from an operations point of view? And also operationally, what's the typical bottleneck that you may see? And then how--what's your comfort level in the company's ability to integrate multiple acquisitions at the same time?

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

Yes, so Paul, let me take a part of that. If I look at Covisint, George Schulze will be leading that in our--is leading that--in our Business Network Group. So in terms of our go-to-market and engineering, it's out of the content services swim lane, so it's a different swim lane in the company. And in terms of Guidance, that's in a different swim lane as well. That's with Gary Weiss in Discovery and Analytics.

We don't necessarily have the ability to control the timing of an acquisition, and when you're ready, you're sort of ready, if you will. I'm certainly not ready, the company's not ready to put an acquisition behind ECD in the content services swim lane, as I like to say, because we've just got a lot, we still have work ahead of us between here and the end of the year.

There's no doubt that the teams, the operations teams, have been busy, the common service teams--finance, IT, legal. But I think they've executed extremely well, and you see that in our Q4 results. We're certainly mindful of making sure we don't clog a swim lane, but I look at Covisint and Guidance, and they're in two completely different swim lanes for the company.

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

And in terms of the general acquisition integration or margin expansion plans, how important is offshoring, either to India or customer support in the Philippines, particularly for some of these smaller businesses that may not have used it in the past?

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

Look, there are, in a software and cloud business, you have three levers. You have automation and you have to continuously automate. Second is people, people expense. There is no doubt that part of the OpenText playbook is leveraging our centers of excellence in Canada and the Philippines and India, and that's an opportunity, typically, across our acquisitions. And then third is leveraging infrastructure cost and scale. We spent our first 25 years scaling up a business model for on-prem, and over the last 5 years we've been scaling up our cloud infrastructure. So when we bring in ANX onboard, we're leveraging GXS and EasyLink. We bring Covisint onboard. We're leveraging the thee acquisitions before that in the cloud infrastructure. We bring Documentum onboard and what they call DaaS, or Documentum as a Service. So we--the levers are automation, people and infrastructure. And that allows us to continue to scale our margin through time.

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

And just the last one for me. Just in regards to the target model, maintenance margins are up by about 200 basis points, or the target's up 200 basis points. I mean, that's driving up the gross margin guidance or target. The--what's driving the increase there?

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

Automation and people.

Operator

The next question comes from Blair Abernethy of Industrial Alliance Securities.

Blair Harold Abernethy - *Industrial Alliance Securities Inc., Research Division - MD of Equity Research & Equity Research Analyst*

Mark, I just wanted to ask you about post your conference, what's the adoption rate looking at for your customers moving up to Suite 16? And as you're seeing them move, are they adding seats or are they adding new modules? What sort of trends you're seeing in the adoption?

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

Yes. It's one of our top opportunities. When we talk about driving organic growth, there are really three pieces. There is competitive replacements, there are the install base, and there's scaling partners. It's our three playbooks. And in the install base, the largest play we have is continue to upgrade customers to Release 16 and getting them to add capacity, more seats, or buy a new module. And Release 16 EP2 is now in market. And I think--I've learned through the years that these enterprise releases are 3- to 4-year runs, if you will, from release to release. And the feedback is strong on Release 16. That's why we've kept what we call this Enhancement Pack series going. So feedback is good and it's filled our top opportunity.

Blair Harold Abernethy - *Industrial Alliance Securities Inc., Research Division - MD of Equity Research & Equity Research Analyst*

And one more quick one, if I could. In the European Union, they're moving ahead, as you are aware, with the general data protection regulation next year around basically, harmonizing a lot of the consumer protection laws. And is there an opportunity there for OpenText either to sell new product, or does it help to expand usage of some of your current European customers' content management systems?

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

Short answer, Blair, is yes. And it's--I think it's a--I want to give kind of two answers here. The first is when we look at case management, contract management, having data zones in our business network, we can offer that, so that's what we offer. So you need all your documents for GDPR. In fact, our win at Volkswagen over FileNet was all about GDPR. You need to run a supply chain and keep all that data, processes and people in Europe because of GDPR or data protection agreements, called DPAs, we'll have those data zones. So I think it's going to differentiate us, and that compliance need--we've always been very strong in compliance and regulations--that will help us.

I also think longer term, as more of these country regulations come in place--HIPAA in the U.S., GDPR in Western Europe, Data Protectorates in Brazil--it begins to kind of separate the market a bit between those who can really scale--and it's one of the reasons on our cloud margin, it's a little below 60% because we're investing for security. We're investing for data zones.

But I think it's also philosophically that as the Internet fragments because of GDPR, because of DPA, because of HIPAA, it will separate other companies out and strengthen OpenText long term.

So I think we're going to wrap up the call, and thank you for joining today and thank you for your questions. This quarter we will be attending the Citibank Global Tech Conference in New York as well a the TD Bank Technology Conference in Toronto and Deutsch Bank's Technology Conference in Las Vegas, and we hope to see you there. That concludes today's call.

John Doolittle - *Open Text Corporation - Executive VP & CFO*

Thanks, everyone.

Operator

This conclude today's conference call. You may disconnect your lines. Thanks for participating. Have a pleasant day.
