

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

OTEX.TO - Q1 2019 Open Text Corp Earnings Call

EVENT DATE/TIME: OCTOBER 31, 2018 / 9:00PM GMT

OVERVIEW:

Co. reported 1Q19 total revenue of \$667m, total revenue on constant-currency basis of \$669m and GAAP net income of \$36m or \$0.13 per diluted share.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

CORPORATE PARTICIPANTS

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

Madhu Ranganathan *Open Text Corporation - Executive VP & CFO*

Mark J. Barrenechea *Open Text Corporation - Vice Chairman, CEO & CTO*

CONFERENCE CALL PARTICIPANTS

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

Daniel Chan *TD Securities Equity Research - Research Analyst*

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

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

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

Stephanie Doris Price *CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst*

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

Walter H Pritchard *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation First Quarter Fiscal 2019 Earnings Conference Call. (Operator Instructions) And the conference is being recorded. (Operator Instructions)

I would now like to turn the conference over to Greg Secord, Vice President, 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 Vice Chair, Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea; and our Executive Vice President and Chief Financial Officer, Madhu Ranganathan. We have some prepared remarks, which will be followed by a question-and-answer session. The call will last approximately 60 minutes with a replay available shortly thereafter.

I'd like to take a moment and direct investors to the Investor Relations section of our website, investors.opentext.com, where we have posted 3 sets of presentations that will be referred to during today's call. First, our OpenText strategy presentation that includes annual fiscal 2018 metrics; second, our Q1 supplement presentation that includes information and financials specific to our quarter; and the third presentation, with additional information about our agreement to acquire Liaison Technologies.

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 future performance result of OpenText, are contained in OpenText's recent Forms 10-K and 10-Q as well as in our press release, which was distributed earlier this afternoon, which also may be found on our website. We undertake no obligation to update these forward-looking statements, unless required to do so by law.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

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 in other materials, which are available on our website.

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

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Thank you, Greg. Hello, everyone, and thank you for joining us today as we provide our first quarter update relative to our progress against the company's annual plan. Let me also encourage you to have our press release and IR presentation in front of you as we go through our call today as well as our corporate presentation and press release announcing we have entered into an agreement to acquire Liaison.

Last quarter, as we kicked off the new fiscal year, we clearly highlighted the metrics that matter. Our business is annual. We look towards long-term trends, not quarterly variances. Our key business metrics include annual recurring revenue, or ARR; adjusted EBITDA; and operating cash flow, or OCF. Fiscal 2019 objectives included low single-digit organic growth and fiscal 2021 objectives included adjusted EBITDA of 38% to 40% and operating cash flow of USD 1 billion.

Let me start the call by saying we remain on that plan, meaning Q1 we delivered to the key business metrics. In fact, this was our best Q1 ever. Let me walk you through those key metrics. Total revenue was \$667 million, up 4% year-over-year. Annual recurring revenues was \$520 million and 78% of total revenues, up 6% year-over-year. Let me note, 2 years ago, in Q1 of fiscal 2017, our total revenue for the quarter was \$492 million. Our ARR this quarter of [\$520 million] (corrected by company after the call) is larger than total revenues of 2 years ago, demonstrating the significance of our focus on ARR and our transition to a recurring revenue business.

Within ARR, cloud was \$208 million, up 7%. Customer support was \$312 million, up 6% year-over-year with 90% margin. Cloud was 58% margin.

On an absolute dollar basis, ARR was up \$30 million year-over-year. Nonrecurring revenues were down slightly by \$4 million. Our increase in recurring revenues far outweigh any slight quarterly decline in nonrecurring.

After Enterprise World, I noted we were going to tap the gas pedal on cloud and recurring revenues, and you can see that reflected in these results today. Adjusted EBITDA was solid at \$246 million or 37% of revenues, up 250 basis points year-over-year. Operating cash flow was solid at \$171 million, up 155% year-over-year. Ending cash was \$788 million, up \$105 million quarter-over-quarter. And adjusted EPS was \$0.60, up \$0.06 or 11% year-over-year.

And we are issuing our quarterly dividend of \$0.1518 per share. That is 22 quarters of consecutive dividend payments. And let me recommunicate our principle of a dividend rate based on approximately 20% of our trailing 12-month cash flow assessed annually each spring. As we grow cash flow, we expect to grow our dividend. It's very simple.

Recurring revenue is the core of our business. And recurring revenue is just that, recurring, steady, predictable, value based for customers and for OpenText. It's customer experience-oriented. It's strategic based on experience and the customer relationships that drive long-term purchasing decisions. And as we service marquee customers, we participate in long-term partnerships, transformative projects and high-margin engagements. This is why global brands select OpenText, such as Citibank, FedEx, General Motors, AT&T, LaRoche, Nestlé, Bank of Montréal, Cargill, British American Tobacco, Fujitsu and companies like Canon. I'm very proud of the team, their accomplishments and the trajectory of the business.

Our focus is on the world's largest and best-run businesses. Global CEOs are certainly talking more about tariffs, taxes, goods and wage inflation, recession, timing and geopolitical issues creating constraints. OpenText is focused on helping the world's leading businesses transform, compete and win in the fourth industrial revolution, both in up economies and in down ones. OpenText has a proven track record in performing within all these scenarios, and we are ready for all these scenarios today.

We're investing over \$300 million in direct R&D this fiscal year for on-cloud and off-cloud products and services. We have a world-class set of products, innovations, industry vertical focus and marquee customers to go win in the \$100 billion total addressable market. We are focused on



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

winning in our core markets of content services, business networks and cloud while growing security, AI and IoT. This is the intelligent and connected enterprise strategy that we laid out in Enterprise World this July.

We continued to strengthen our business model with recurring revenues at 78% of our total revenues, and our margins are expanding to best-in-class territory. Our sales coverage expands in a steady and cost-effective way through indirect sales such as global system implementers, value-added resellers, cloud hyperscalers and our own inside sales efforts. As customers face tariffs and good and wage inflation, we help them get lean with digital, intelligent and connected cloud solutions, security and analytics and AI. They can reduce their cost structure and get more secure as they transition to the OpenText Cloud.

I was speaking with a CEO recently who is moving a production plant in China to Southeast Asia due to tariffs, lower labor cost and capacity constraints. Whereas they may take them up to 6 months to make the physical move, they just need to unplug and replug into the OpenText Cloud for their digital supply chain and go. We are taking this opportunity to refocus and execute in our core solution markets of content services, B2B networks and cloud services and our core go-to-market sales theaters of North America, Western Europe, Japan and Australia and New Zealand. We have limited emerging market downside exposure, but we have upside growth potential in all those markets.

The restructuring efforts announced in August, along with the productivity enhancements, leave us rightsized, ahead of the curve and more agile. Our balance sheet is strong. We're a proven consolidator with a value-oriented point of view. We are ready to effectively deploy our capital as reflected in our announcement today with Liaison Technologies, which I'll speak to in a moment. And our future framework is built on the power of our market leadership with our global expertise in talent and performance metrics at our foundation.

The technology infrastructure sector has few companies with our profile: multibillion dollars in revenue; a consistent track record of delivering total growth, margins and cash flows; disciplined capital allocation with equal opportunities in up and down markets. We are firmly in the upper right-hand quadrant when compared to our sector peers with a long-term strategic plan to deliver shareholder value.

I'd like to spend a few moments on Q2. We expect the quarter to be seasonally strong with sequential revenue growth in the mid- to high single digits. As I note, I made similar comments last Q1. Also, we have a tougher year-over-year comparison due to the Covisint and Guidance acquisition revenues in Q2 of last year. Further, we introduced quarterly factors last quarter. These factors -- these are factors that may affect our results, and we ask you to incorporate these into your analysis of our business. Our Q2 factors include, a reminder that our business is annual and of course will vary. Q2 is seasonally strong; we have a tougher year-over-year comparison, as noted earlier; tariffs, goods and wage inflation; more public discussions on the nature of the next recession and its timing; continued U.S. dollar strength against the euro, pound, Canadian dollar and yen; and continued cloud investment on the OpenText side.

Let me turn a bit to Liaison. We announced earlier today, we signed a definitive agreement to acquire Liaison. Liaison is the leading provider of cloud-based enterprise application integration and data management solutions. They are based in Alpharetta, Georgia, and have approximately 475 employees and 4,000 global enterprise customers. As our customers digitize and integrate their global value chains, Liaison is a powerful transformation agent and will complement our GX5 EasyLink, Covisint and ANX platforms and further add to our cloud growth. The transaction value is \$310 million. We'll use cash on hand, and we will provide our business case -- business update upon closing. The acquisition is subject to customary closing conditions, and we expect to close over the next 90 days. I look forward to welcoming Liaison customers, partners, trading partners and employees to OpenText and our global platform.

In summary, we focused on the metrics that mattered and delivered our best Q1. These are solid metrics of annual recurring revenue, adjusted EBITDA and operating cash flow, coupled with margin expansion. We have a strong balance sheet. And as a proven aggregator, we have the capital to put to work. Our Q1 restructuring has created a rightsized organization and ahead of the curve to outperform in all economic scenarios. We have momentum in the OpenText Cloud with our business network, managed services and our new OT2 and SaaS applications. We continue to track to our fiscal '19 target model and our fiscal '21 adjusted EBITDA and OCF goals. In a shifting landscape, we plan to take share from competitors. We are ready for all scenarios and positioned to ensure all our stakeholders win: our customers, employees, partners, communities and shareholders. While markets may become volatile, OpenText will perform.

It's my pleasure to hand the call over to our CFO, Madhu Ranganathan. Madhu?

OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

Madhu Ranganathan - *Open Text Corporation - Executive VP & CFO*

Mark, thank you, and hello, and thank you all for joining us today. During the last earnings call, we shared with you our communication framework. We shared our fiscal 2018 annual organic growth and return on invested capital, ROIC, and indicated that we will provide those 2 metrics at the end of each fiscal year. We directionally provided that, subject to a quarterly variability, our organic growth will be in the low single digits for the full year of fiscal 2019. We also introduced quarterly factors to provide additional quarter-to-quarter visibility into general market factors and some short-term context that may affect our quarterly results but are not relevant to the long-term health and strategic nature of our business. The objective of such a communication framework of annual metrics, quarterly factors, along with management commentaries, is to help you model OpenText in a way that is closely aligned to how we see the business and reduce unnecessary short-term trading volatility for our long-term shareholders.

And now turning to our quarterly financial results and similar to prior quarters, my references will all be rounded in millions of U.S. dollars and compared to the same period in the prior fiscal year. Total revenue for the quarter was \$667 million, up 4% from last year or \$669 million on a constant currency basis, also up 4%. Our geographical split of revenues in Americas, EMEA and APJ was 58%, 32% and 10%, respectively, and that was consistent with the prior year.

During the first quarter, we had 14 deals over \$1 million in value, same as last year, 9 in the OpenText Cloud versus 7 in prior year and 5 on-premise versus 7 in the prior year. We delivered \$77 million in license revenues, down 2% compared to the prior year; and \$56 million in new MCV, down 15% compared to the prior year. Annual recurring revenue was \$520 million for the quarter, up 6% on both a reported and constant currency basis. The geographical split was consistent among the regions relating to our annual recurring revenue components of cloud and customer support revenues. Professional services revenues were \$71 million, down slightly from \$73 million in the year-ago same period.

And now to foreign exchange. As mentioned in our last call, we expected fiscal 2019 revenues to be negatively impacted by FX of approximately \$60 million. To give you a perspective, our Q1 revenues were down \$12 million over Q4 due to FX. And looking into a basket of currencies, we expect Q2 revenues to continue to be negatively impacted by FX.

Turning to margin performance. We continue to have a clear and deep operating lens into all aspects of our business as shown in our results for adjusted gross margins and high carry-through to adjusted EBITDA. Our adjusted gross margin for the quarter was 73% with consistent improvement in annual recurring revenue lines. Cloud was 58%, up slightly from 57% last year. Customer support was 90%, up slightly from 89% last year. Our license margin was 95%, down slightly from 96% last year. And professional services margin was 20%, stable compared to last year. Our adjusted EBITDA was \$246 million this quarter, up 12% year-over-year. Adjusted EBITDA margin was 37%, an increase of approximately 250 basis points compared to 34% in the prior fiscal year. Our adjusted earnings per share for the quarter was \$0.60 on a diluted basis, up 11% compared to \$0.54 per share in the same period last year. GAAP net income for the quarter was \$36 million or \$0.13 per share on a diluted basis compared to \$37 million or \$0.14 per share for the same period last year. The decrease was primarily driven by FX losses incurred this quarter compared to FX gains recognized last year. Operating cash flows were up 155% year-over-year to \$171 million. Our diligence in collections and a long-term commitment to optimizing DSOs were key drivers and remain at the foundation of our operational performance, although our cash flows can fluctuate quarter-to-quarter given the underlying seasonality in our business.

And now turning to the balance sheet. We ended the quarter with \$788 million of cash and \$626 million of deferred revenue. As of September 30, our consolidated net leverage ratio was 1.7x, well within our external debt covenant ratio of 4.0x and down from a peak of 2.6x from a year ago.

And now an update on restructuring. During our last call, we outlined a restructuring initiative which was successfully executed during Q1. While the majority of the \$29 million charge was incurred in Q1, the remainder will be incurred throughout fiscal 2019. Our estimated savings is consistent with our updates during last quarter.

We expect to realize approximately \$20 million during fiscal 2019 with about 2/3 expected to accrue during the second half of fiscal 2019. The full benefits of approximately \$50 million expected to be realized in fiscal 2020 and beyond. The impact of restructuring is already factored in our fiscal 2019 target model.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

And with respect to the IRS matter, there is nothing new to report on our ongoing process with the IRS. We will continue to keep you updated on any material new developments.

And now for perspectives on our operating model. Mark shared with you the quarterly factors earlier in the call. As you heard from Mark, we are getting more productive. During the first quarter, we had solid metrics across the P&L and the balance sheet. And you see it on the face of income statement, adjusted EBITDA, operating cash flows and confidence in our FY '19 target model, which remains unchanged and posted on our Investor Relations website.

In addition to Mark's comments on revenues, let me walk you through our margins and expenses. With respect to gross margins, our license and customer support growth margins have been well optimized. We expect cloud margins to remain at the improved Q1 levels during the second quarter of fiscal 2019 and annually remaining within our FY 2019 target model. We still expect PS margins to remain on our model between 18% to 20%.

And now for sales and marketing. Certain expenses, such as commissions and incentives follow revenue goals, and they increase as the year progresses based on quota attainments as is typical for a technology business.

Specific to R&D, as Mark mentioned, we remained very proud of and committed to our R&D investments. Five years ago, our R&D investment was \$177 million annually compared to \$323 million in fiscal 2018, an increase of 82%. As we continue to invest in fiscal 2019, please look to our target model for the range of spending. G&A spending is expected to be within our target model at the mid to high end of the range. As for overall expenses seasonality, our history would suggest that Q2 was a peak margin for the year. Q3 is a low point of the fiscal year and Q4 is a strong margin quarter, albeit below Q2 levels. We suggest you build out your models for the remainder of the year accordingly.

During our last quarter, we updated our interest and other expense range for the year, which is expected to be between \$144 million and \$149 million in the fiscal year, while our adjusted tax rate remains at 14% for the fiscal year.

And with respect to Liaison Technologies, further details on Liaison's expected financial contribution and integrated business plan will be disclosed following close of the transaction. We advise you to not model Liaison's integrated financials until such time.

And now turning to our long-term targets. As Mark mentioned, our fiscal 2021 targets remain the same: our adjusted EBITDA margin in fiscal 2021 of 38% to 40%; our plans are in place, and we are in full execution mode; automation in cloud, in customer onboarding and customer support and renewals is our focus; people, to increase our center of excellence participation in India, Philippines and Canada and further strengthening of our worldwide procurement organization to optimize over \$1 billion of spend annually. And you can see the progress to our FY '21 goals, even within this quarter with cloud margin at 58% and CS margins at 90%. To reiterate, our quarters could vary, but our plans are in place and we are executing.

And now for the operating cash flows target of \$1 billion annually as we exit fiscal 2021. We have multiple scenarios to achieve this objective, and it is a combination of paths, including M&A, organic growth, productivity gains and margin expansion. We have confidence and flexibility in terms of how we choose to turn the dials to get there.

In summary, we remain on track for our FY '19 target model, and subject to quarterly variability, low single-digit organic growth for fiscal 2019. And looking into a basket of currencies, we expect Q2 revenues to continue to be negatively impacted by FX. While considering FX and the seasonal strength in Q2, as Mark mentioned, we see sequential revenue growth in the mid- to high single digits. As a reminder, during Q2 of last fiscal year, our revenues included a full quarter of Covisint and Guidance acquisitions, which contributed to a higher sequential growth rate; well-optimized license and customer support gross margins while maintaining cloud gross margins at our improved Q1 levels of 58%; our directional trends in sales and marketing, R&D and G&A based on the details I had provided earlier. And lastly, as a reminder, we advise you to not include Liaison Technologies financials and an integrated model until we provide you with further details following closing of the transaction.

The OpenText team is a dynamic group and extremely talented. I want to take this opportunity to thank the team for their deep commitment to our first quarter initiatives and the continued focus on productivity and efficiency. We look forward to meeting with many of you during the November and December time frame as part of our investor meetings in Canada and the United States. We appreciate your support and close



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

alignment to all aspects of our communication framework for the benefit of our long-term shareholders whose trust and confidence we greatly value.

I would now like to open the call for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Phillip Huang of Barclays.

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

Maybe a first question for Mark on the macro environment. You mentioned in your remarks some of the headwinds, including the trade tensions and FX markets. Obviously, you have solutions that help customers sort of deal with such evolving macro environment. But I was wondering from your conversation with customers, are you seeing any hesitation on their spending plans or perhaps looking to shift spending towards certain solutions over others? And also, do you see any particular vertical that perhaps might be more exposed or vulnerable than others?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Phillip, thank you for the question. If you can kind of look to the earnings season here, we're probably on the second half of sort of the earnings calls, if you will, so we have the benefit of being a bit more, if you will, into the calendar year. Look, we all read the same newspapers and kind of read the same headlines. To repeat, it's growing discussion around tariffs, and it's not just putting tariffs in place but now seeing the next set of phases of that where certain industries may have done some prebuys and now they see price increases. It's in that maybe third phase of a 5-stage process. Certainly, you can see vendors increasing prices, some wage inflation as well and growing narrative around what would a recession look like and when would it arrive. So we're not seeing that to translate today into pipeline changes or spending differences, but the narrative is way up. And the next step is to see it translate, but the narrative is very high. We think we're in a good position regardless of the economic scenario, whether the economy is up or down. And this is a mature team. I've lived through up economies and down economies. And our structuring puts us in a great place to have a more optimized cost structure, more agile. Our solution portfolio has helped customers navigate through all scenarios, moving manufacturing facilities, getting leaner, more digitalization. And if market valuations change as a consolidator were to -- a value point of view and a healthy balance sheet, we're in a strong position to gain share quickly. So to answer the question, it hasn't translated directly into any pipeline change. We watch it closely. We all read the same headline, and we're ready for all scenarios, up or down.

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

That's very helpful. I was wondering, just curious when your sale team go out to the customer with the sort of conversations, talking a little bit more about the narrative in the case of recession and such, are there specific solutions that you guys are pitching a little bit more? Or are you sort of modifying the pitch to customers a little bit in order to kind of help them prepare for the changing macro environment?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Certainly is. I would describe it as a -- we can help support a growth message for the Global 10,000. We can help support a value message for the Global 10,000, and part of that value message is time to transition to the OpenText Cloud. We can help you reduce your labor. We can help you move your physical environment into a digital. You need to move a plant from China to Southeast Asia, you need -- you can't go to market and get very expensive skills, so I will lead with, in support of our recurring revenues, that our #1 message to customers in a downtick would be migrate to the OpenText Cloud.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

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

That's helpful, Mark. And maybe a quick question for Madhu as well. I don't know if I missed it. But what was the impact in the quarter from ASC 606 and also FX?

Madhu Ranganathan - Open Text Corporation - Executive VP & CFO

No. Sure thing. On 606, it's actually in our 10-Q. There was about \$4 million, about \$3.8 million of positive impact to revenue. And then when you consider the cost side of it as well, it's about \$4 million positive from a margin standpoint. And on FX, as I shared before, about \$12.4 million of negative impact to revenue in Q1 as you compare to the exchange rates in Q4.

Operator

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

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

Yes. I want to sort of ask sort of along that line from context on the M&A funnel. Has the environment changed in any way over the past, let's call it, 6 months here from last year?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Richard, thanks for the question. Mark here. I'll reemphasize that it's good planning by any large business to be ready for sort of all scenarios, in up scenarios and down scenarios, and we're going to help our customers navigate through both. Certainly, as market valuations shift a bit, we're in a great position given our value-oriented approach. I would say that our pipeline activity and M&A is up. We're engaged in more conversations, and we think that's a good thing as a consolidator. So yes, there's been a difference over the last 6 months.

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

Okay. And then with respect to organic growth, I know you guys are probably not providing that this quarter. But if I could sort of look back at that single digit target that you have here, what would you say kind of like are the top -- the greatest opportunities from an organic perspective of all your product lines here?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

I'd highlight top 3. It's, one, transition to the OpenText Cloud and our continued ability to migrate existing customers and have them maintain the ownership of their license, grow our customer support revenue. I'll take this as an opportunity just to a shout-out with \$312 million of support revenue, up 6%. We hit 90% margin, first time, 90% margin. This is upper right-hand quadrant performance of customer support, which really shows the value of that experience and that engagement and the satisfaction and the value they're gaining from our platform. So the number one path on organic growth is that continued transition and additive nature to the OpenText Cloud and recurring revenues. Second is driving security, security into our entire install base. Let me just pause there. I'd say those are probably the 2 largest ones.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

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

Okay. And one last one for me. You made a comment earlier in your remarks about some wage inflation, and we certainly sort of notice that across the board in some other names. Like to what degree are you sort of seeing that across the base? Is it coming across all areas of business, from R&D to sales? Or is it sort of localized in one specific operating cost line?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Yes. I would -- I'd say it's primarily oriented in the U.S. right now. It's a sort of unique scenario in the United States where you have GDP growth higher than unemployment, and that's an interesting phenomenon. So a few years ago, we've decided that we were going to double down candidly in Canada, India, in Philippines, and that's worked out pretty well for us. But in terms of wage inflation, I just point to the macro indicators in the U.S. where GDP growth is higher than unemployment rate. So everyone's fighting for those -- for more jobs, and we continue expand our -- our employee bases in Canada, India and the Philippines.

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

Okay. And sorry, I just want to slip up this comment. Do your targets incorporate sort of that level of inflation and when it comes to your margins here going forward?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Yes, they do. It's an all-in scenario.

Operator

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

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

Mark, if I'm doing the math correctly, it seems like organic growth will be relatively flat in the first half of '19. And so that would imply that your guidance for low single-digit organic growth for the full year is back-end loaded. So I guess, firstly, I don't know if you can comment whether my math is correct. But secondly, could you comment on whether there would be reasons to expect an acceleration in organic growth in the second half?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Yes. Thanks for the question, Thanos. I'll go back to my prepared remarks. We're on target to grow low single digit organically this year. In terms of our Q2 quarterly factors, it is a tougher Q2 compare because if you go back to Q2 last year, we had a lot of acquisition revenue from Covisint and Guidance in Q2 of last year. And we're going to update annually on the actual quantum of organic growth. We grew -- we had positive organic growth in Q1. And you'll have to run your model of how you want to spread that out and what number you want to use. But I'll confirm, we had positive organic growth in Q1, tougher compare in Q2. And we're on target to grow low single digit organically for the fiscal year. Madhu, anything you'd like to add to that?

Madhu Ranganathan - *Open Text Corporation - Executive VP & CFO*

No. I agree with that. No, thank you, Mark.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

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

Okay. That commentary was very helpful. On Liaison, just one question I have is can you comment on whether there was any specific concentration from a vertical industry perspective? Seems like there have been a lot in life sciences. Or is it quite diversified there?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Yes, thank you for that. We're very excited about Liaison. They are -- we'll come out with the business case once we close. I'm sure you'll go look at public sources and understand the better business more fulsomely. In terms of industries, they're business-to-business integration, they're application-to-application integration, these are markets where MuleSoft plays, where Informatica plays as well as our traditional markets. We posted on our Investor site the magic quadrant. On the upper right-hand quadrant is ourselves, GXS and IBM as well as some new markets of MulesSoft and Informatica. This puts us into the verticals such as heavy industrial processing, puts us into pharmaceuticals, strong process industries, if you will. So it's a nice industry add to where Covisint was in auto and transportation, GXS was in CPG and retail more so, and Liaison more in process and heavy industries.

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

Great. And last one for me. Now that you've had Documentum for a while longer, any change in maintenance renewal rates? Or has that been holding steady?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

I think you see the power of the acquisition and the integration right here in the quarter. Again, I'll go to support revenue, up \$312 million, up 6%, 90% margin. This is the power of scale. And as we -- 2 years ago, if you'll allow me to kind of make this point. Two years ago, fiscal '17 Q1, our total revenue for the company, this is pre-Documentum, total revenue for the company was \$492 million, total revenue. Today, our annual recurring revenue is \$520 million, bigger than all of total revenue from Q1. So it was an asset purchase. Asset purchases take a little longer. We all know it's -- as we talked many quarters ago, fully integrated. But I think you're seeing the power of that integration, the scale, better renewal rates flowing into the business, up 6% year-over-year, \$312 million, 90% margin.

Operator

The next question comes from Stephanie Price with CIBC.

Stephanie Doris Price - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst*

You've talked quite a bit about the cloud on the call. Can you just give us a bit of an update on the early interest and the uptake in OT2? And what the pipeline for the cloud solutions, in general, is looking like here?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Steph, thanks for the question. I introduced some new language in my script. I'm -- we're changing the emphasis. We're talking about cloud and off-cloud. Off-cloud, being our nonrecurring revenue of license and PS, and so we have our off-cloud solutions and our cloud solutions. So we're going to introduce some new language here, clearly with the emphasis on cloud. Three major swim lanes to our cloud. First is our business network cloud, and that is our value-added network. That is our on-demand messaging. This is where Covisint and ANX added a lot of value. Liaison will provide enormous value there in the business network cloud. The second is our managed services where we bring customers environments into



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

the OpenText Cloud, and we run them fully. It could be a content services cloud, could be a supply chain cloud. We had 2 great wins in the quarter. L'Oreal moving into our managed services on a global basis. We won Opel to come into our managed services cloud. And our third swim lane is our new OT2 platform, which is our public environment, multi-tenant SaaS platform. And we're on now quarterly releases. We have our next quarter release going out in 2 weeks actually. So OT2, 18.4. Our naming convention will first be the year, '18, '19, '20; and the next dot will be the quarter. So OT2 18.4 goes into full production. And our subscribers are up. Our revenue is up. And I expect when we start to get into fiscal '20, it's going to have a contribution to the business, opening up that third swim lane. And if I can kind of go back to a couple of questions ago that probably be the third driver to our organic growth is sort of new revenues coming in through OT2.

Stephanie Doris Price - CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst

Great. And then in terms of partners, you announced a partnership with NessPro in Israel this quarter. Can you talk a bit about new partnerships and other regions that you would like to enter with, with partners?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Steph, thank you for that. I had a comment in my prepared remarks talking a little bit about extending our sales coverage. And we've put a team in place. It's a long-term investment. It's about culture and continuous progress within the organization, and it's all around partners and alliances. A simpler way to kind of say it's just indirect sales, right. We got our direct sales force and we go out and engage directly. And we have our indirect sales force, that is partners and alliances. So the biggest thrust in there is the global system implementers: Accenture, Deloitte and companies of that ilk, and we're making great progress there. We've refined our value-added resellers, and we're getting closer to the hyperscalers that we announced at Enterprise World where we'll now run our managed services on the Google Cloud Platform, on Azure as well as Amazon. And then we have our own in-site sales that we'll go to market with a variety of solutions. So we're going to continue to highlight it. It's a cost-effective way to get coverage in a variety of countries that we may not be in or account coverage and doing that at high efficiency and low cost.

Operator

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

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

Just in regards to a commentary momentum that you're seeing in cloud relative to license or off-cloud, could you just -- is there any way to quantify it? I know it's been a couple of quarters since you haven't disclosed MCV, but \$1 million-plus cloud deals are up year-over-year. So any sort of additional commentary just in regards to momentum in the cloud and what you're seeing on the booking side.

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Well, I mean, I'd kind of point to the recurring revenue, up on an absolute -- put percentages aside for a moment because percentages may not tell the full story because you need both a numerator and denominator. But if we look at our annual recurring revenue within the quarter, it's up on an absolute basis, \$30 million. And our nonrecurring revenue is down \$4 million. So the percent, up. It's 6%. And now the nonrecurring, we had a percent down, is 4%. But I think the absolute number tells us a story right there. ARR up on an absolute basis, \$30 million; and nonrecurring, down just \$4 million.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

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

Okay. And then just shifting to M&A and Liaison, I mean, you're not disclosing financials or commenting at this point. But just speaking generally, is your -- is the target still typically to bring acquisitions in line with your margin target within 1 year? And is there any reason why Liaison would deviate from that model?

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Correct. Our model is to onboard a business within the first year. And based on what we see here, I wouldn't expect Liaison to vary from that.

Operator

The next question comes from Walter Pritchard with Citigroup.

Walter H Pritchard - Citigroup Inc, Research Division - MD and U.S. Software Analyst

Question first for Mark. On the growth side, I'm wondering given -- it feels like in this macro, which has been good for a while, everybody, including yourselves, has had pretty good price umbrella and enabling growth through pricing and price optimization. Can you help us understand, maybe looking historically, how much of a help that's been? And I assume if we get into a little bit tougher macro, that probably becomes a tougher lever to pull.

Mark J. Barrenechea - Open Text Corporation - Vice Chairman, CEO & CTO

Walter, thanks for the question. It's an interesting set of economic scenarios. It's not sort of a traditional set of variables, right. We look at the U.S. which for a lot of companies is 50% of their business, where you have GDP still higher than unemployment. So the biggest concern, really, is inflation and does inflation slow things down, generally speaking. You see Oracle raising prices. I got an e-mail from Microsoft today raising prices. And we're in the market, too, raising our prices around our customer support. We announced at Enterprise World our Prime Protect, which is bringing up a couple of hundred basis points; our CS program. We look at our PS rate cards and we're adjusting for FX, and thus, bringing up our PS rate cards as well. I think on the renewal side, we all focus on cost-of-living adjustment and the mechanics of a very large contract annuity base, both in the cloud and off-cloud. But when it comes to selling a new license or selling a new long-term cloud agreement, you still have to compete on value. And it's a value-based sell, and thus, an ROI-based sale. So I think it's a mixture of you have mechanics where you got to adjust for FX and some inflation, which we're doing our share of. But in kind of new longer-term contracts, you're still competing on value. Hope that's helpful.

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

And then for Madhu, on -- yes, it does. And then for Madhu on the cloud margin side, you've talked quite a bit about that the last several quarters, and you've given us a little bit of different view on the cloud makeup, which understanding one of the pieces is pretty small right now. But as we think about the margins in cloud and sort of mix helping to drive margins, can you help us understand how that would play out? And then also, are there any things we should be watching over the next few quarters that are -- that you helped to enable those margins to go higher other than scale?

Madhu Ranganathan - Open Text Corporation - Executive VP & CFO

It's a great question. So there are probably 3 aspects to it, and mix is certainly one of those. But also keep in mind, as we continue to drive the productivity and efficiency, we also need to continue to invest in the cloud. And hence, our direction to you, although it's improved in Q1 to 58%, to keep it at those levels that balances off the productivity, efficiency as well as the investment that we need to make. And I think looking longer



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

term, we've shared this before, I think getting into the 60s, low 60s on the cloud margin, we've talked about it, but that is a much longer-term goal. But this year, I would encourage that we look at it at the Q1 levels as we balance off the 3 aspects we talk about.

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 of Technology*

Mark, I wonder if you could just shed a little more color on how progress is -- how you're making progress on moving what would be sort of traditional license, on-premise license customers to managed services and whether or not they're opting to go or look at OT2. Or how are you sort of managing that shift? And I guess the other side of the question is what's the revenue lift opportunity of just taking an on-premise guy going to managed services with his existing license versus going to, say, OT2?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Yes. Fair enough. And, Blair, thanks for the question. I'd start with sort of a principle-based answer, and excuse me if I'm repeating myself from a couple of years ago. But it's an important principle because we took a different stance than other companies. Our view was we have a very large install base, very important install base. And we weren't interested in substituting that revenue, that maintenance revenue, substituting it for a cloud dollar, if you will. Our principle -- and we were willing to give things up for that. Our principle was to go after the dollar add, not the dollar substitute, if you will. And that paid off, where customers enjoy owning the license. It has economic value. In fact, it's more economical for our customer to own a license. If they want to own it for more than -- I always like to use the number 42 months. 42 months solves a lot of things. But our experience shows after 42 months, it's more economic to own that license than it is to be in a subscription. So we made that principle decision. Other companies went for the substitution approach. And I think that's paid off for us. Again, I won't repeat the ARR numbers from the quarter. I think you see that principle decision flowing through our P&L today, so it's an add. And it's an add of the infrastructure opportunity. It's an add of the application management opportunity. And now that as they migrate into the cloud, customers reduce their labor, increase their dependence on us. It's -- the opportunity to add future solutions on top of that. So I'm not going to put a -- it's hard to put a quantum on it, but I would open up those 3 areas of it's infrastructure dollars, it's application management dollars and it's new solution dollars on top of that. In terms of OT2, we're being very selective on the workloads because, again, we don't want to substitute a dollar. We want a dollar add. So we tend to be adding new features, new workloads into OT2. So we can -- we will see that as, again, additive dollars to what we're doing, not substituting existing dollars.

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

Okay. That's very helpful. And then just shifting gears to one of your organic growth drivers is competitive replacement. Could you just give us an update on how you're proceeding there, in particular with the fact that you've got -- you've had the Documentum business with you for sometime as well? So how are you doing in the market competitively?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Well, Blair, I don't want to come off with a hubris-type answer, but that's the \$34 billion question in the marketplace. I will point to IBM. And I look at IBM's recent decision in the marketplace, and it's going to be an opportunity for OpenText. They're going to be focused on this new very expensive thing they're doing, and we're going to stay focused on filing it, Sterling Commerce. I thought Watson was what they're going to lead with. Sounds like they're going to lead with open source, so we're going to have an opportunity on analytics as well. So on the competitive replacement front, we talked about a few quarters ago that we're going to be laser-focused on IBM, and that's even more acute today.



OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

Operator

The next question comes from Daniel Chan of TD Securities.

Daniel Chan - *TD Securities Equity Research - Research Analyst*

Just wonder if you could comment on the seasonality. It seems like seasonality was a bit more pronounced this quarter. I think in the last 5 years, it's been down about 2% to 3% sequentially. And this quarter, we saw about 12%. Is there anything specific to this quarter that we should be thinking about? And should we see more seasonality as we move through the rest of the fiscal year?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Dan, thanks for the question. No. I don't believe so. We came off a very strong Q4 rolling into Q1, and our Q2 has a slightly tougher compare year-over-year just given all the Covisint and Guidance acquisition revenue from a year ago. So no change to our views of seasonality. I would just note we came off a very strong Q4, and we just have a slightly tougher compare given Guidance and Covisint of a year ago.

Daniel Chan - *TD Securities Equity Research - Research Analyst*

Okay. And then I just had a follow-up question on the margins. This is the second quarter you've got about 37% EBITDA margins. Is this kind of the new level and we move higher here as you move towards your fiscal '19 goals? And what are the kind of the puts and takes that will get you to either the high end of that range and to the lower end of that range?

Madhu Ranganathan - *Open Text Corporation - Executive VP & CFO*

Want to take that?

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Over to Madhu.

Madhu Ranganathan - *Open Text Corporation - Executive VP & CFO*

Sure, sure. Thanks for the question there. As we shared in the commentary, we do have the ups and downs in the margins as well, right. So your Q2 is going to be a bit higher and Q3 lower. But Q2, again -- Q2 and Q4, there's a comparison there as well. I would still point out to our target model range. We have baked in, number one, you talked about the drivers. The whole essence of doing the restructuring early on in the fiscal year, we've baked that into our target model. So I would continue to look at our target model for that. And when you think about the balance of investments, I answered the earlier questions in the cloud, we really have to balance between the efficiencies we'll do to "fund" the investment we'll do to keep the cloud at the Q1 levels as well. That's how we would look at FY '19.

Operator

This concludes time allocated for questions on today's call. I will now hand the call back over to Mark Barrenechea for any closing remarks.

Mark J. Barrenechea - *Open Text Corporation - Vice Chairman, CEO & CTO*

Ben, thank you, and thank you, everyone, for joining today. Madhu, thank you for your remarks.

OCTOBER 31, 2018 / 9:00PM, OTEX.TO - Q1 2019 Open Text Corp Earnings Call

I just like to recap that we focused on and we continue to focus on the metrics that matter: ARR, up 6%, \$520 million within the quarter; cloud, up 7% at 58% margin; support hit a record margin of 90%, up 6% to \$312 million; adjusted EBITDA, up 37% or \$246 million, up 250 basis points; OCF of \$171 million, up 155%; and ending cash at \$788 million. And we're very excited about the acquisition we announced today of Liaison Technologies.

Thank you for joining, and we'll speak to you all very soon. Thank you.

Madhu Ranganathan - *Open Text Corporation - Executive VP & CFO*

Yes. Thank you.

Operator

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

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.

