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OTC.TO - Q2 2014 Open Text Earnings Conference Call

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OVERVIEW:

OTC.TO reported 2Q14 total revenue of $364m, GAAP net income (before taxes) of $70.2m and GAAP diluted EPS of $0.90.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the OpenText Corporation second quarter fiscal year 2014 results conference call.

(Operator Instructions)

This conference is being recorded today, Thursday, January 23, 2014. I would now like to turn the conference over to Mr. Greg Secord. Please, go ahead, Sir.

Greg Secord - ***OpenText Corp - VP- IR***

Thank you, Damien, and good morning, everybody -- good afternoon, actually. I would like to start the call with the reading of our Safe Harbor statement.

Please note that during the course of this conference call we may make statements relating to the future performance of OpenText and contain forward-looking information.

While these forward-looking statements represent our current judgment, actual results could differ materially from a conclusion's forecast or projection in the forward-looking statements made today. Certain material factors or assumptions were applied in drawing any such conclusion while making any such forecast or projection as reflected in the forward-looking information.

Additional information about the material factors that could cause actual results to differ materially from the conclusion forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing the conclusion while making the forecast or projection as reflected in the forward-looking information as well as the risk factors that may project future performance results of OpenText are all contained in OpenText's forms 10K and 10-Q as well as in our press release that was distributed earlier today, each of which may be found on our website.

We undertake no obligation to update these forward-looking statements unless required to do so by law. In addition our conference call will include a discussion of certain non-GAAP financial measures. Reconciliations of all non-GAAP financial measures to their most directly comparable GAAP measures have been included in today's press release, which may be found on our website.

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

I would also like to direct investors to the Investor Relations section of our website where we posted an updated PowerPoint that we will be referring to during this call as well as a summary table highlighting OpenText historical trend in financial metrics. And, with that, I'll hand the call over to Paul McFeeters.

Paul McFeeters *- OpenText Corp - CFO*

Thank you, Greg. Turning to the financial results, I will highlight our second quarter of fiscal year 2014. Total revenue for the quarter was $364 million, up 3% compared to $352 million for the same period last year. Regionally, the Americas contributed 51%, EMEA 39%, and Asia Pacific 10%.

License revenue for the qu10arter was $81 million, up 7% compared to $76 million reported for the same period last year. We saw license revenue broken down by vertical sector as 22% from financial services, 17% from services, 14% from public sector, 11% from basic materials, 10% from technology, 10% from consumer goods, 7% from healthcare, 6% from industrial goods, and 3% from utilities.

Cloud services revenue for the quarter was $42 million, down 6% compared to $45 million in the same period last year. Cloud service gross margin was 62.1% in the current quarter compared to 60% for the same period last year. A reduction in TelCom, collocation fees and third-party technology costs contributed to the higher margins for this quarter compared to the same period last year.

Customer support revenue for the quarter was $174 million, up 6% compared to $165 million in the same period last year. Customer support gross margin was 86% in the current quarter compared to 82.8% for the same period last year. The increase in customer support margin was due to a reduction in third-party technology costs and employee savings.

Professional services and other revenue for the quarter was $66 million, down slightly by 1% compared to $67 million in the same period last year. The professional services gross margin was 22.1% in the current quarter versus 26% for the same period last year. The decrease of margin was primarily the result of a higher use of subcontractors this quarter compared to the same period last year.

Gross margin for the quarter before amortization of acquired technology and stock compensation charges was 74% compared to 71.5% for the same period last year. Pretax adjusted operating margin before interest expense and stock compensation was $112 million this quarter, down compared to $113 million in Q2 the last fiscal year.

Adjusted net income was $94 million this quarter, up from $93 million in Q2 of the last fiscal year. Adjusted EPS was flat year over year at $1.58 per share on a diluted basis. The sequential effect of foreign currency movement on adjusted EPS for Q2 was a positive $0.03.

The adjusted tax rate for the quarter was 14%, the same as it was last fiscal year. On a GAAP basis, income from operations before interest and taxes for the second quarter was $73.9 million, up 10% from $67.2 million in the second quarter last year. GAAP net income before taxes was $70.2 million in the current quarter versus $64.3 million in the same period last year.

Net income for the second quarter in accordance with GAAP was $53.5 million, or $0.90 per share on a diluted basis, compared to $61.1 million, or $1.04 per share on a diluted basis, in the same period a year ago.

Operating cash flow for the quarter was $60.9 million compared to $74.7 million in the same period last year.

The lower operating cash flow was primarily due to a lower opening account receivable balance in the current quarter of $153 million compared to $170 million at the same point in time in fiscal 2013. There were approximately 59.6 million shares outstanding on a forward-looking basis for the second quarter of fiscal 2014.

On the balance sheet at December 31, 2013, deferred revenues were $260 million compared to $253 million as of December 31, 2012. Accounts Receivable was $173 million at December 31, 2013, compared to $175 million at June 30, 2013, and $168 million as of December 31, 2012.

Days Sales Outstanding were 43 days as of December, 31, 2013, compared to 45 days as of June 30, 2013, and 43 days as of December 31, 2012. On December 31, 2013, our headcount was approximately 5,300 comprised of 1,500 in R&D, 200 in cloud services, 700 in customer support, 1,000 in professional services, 1,150 in sales and marketing, and 750 in G&A.

Additionally, on January 16, we acquired approximately 3,000 more employees from the acquisition of GXS.

On January 23, 2014, the Board declared a two-for-one split by way of a stock dividend of our outstanding common shares. The record date for the stock dividend will be February 7, 2014; and the payment date will be February 18, 2014.

Our Board also declared a cash dividend of $0.15 per share, or $0.30 per share on a pre-stock split basis, for shareholders of record on February 21, 2014, payable on March 14, 2014.

On January 16 we announced our acquisition of GXS. The total purchase price comprised of approximately $1.1 billion in cash and the issuance of approximately 1.3 million OpenText common shares.

To fund the acquisition, we entered into a new term loan B and borrowed $800 million. The term loan B is a seven-year term and repayments made will be equal to 0.25% of 1% of the original principal amount and equal quarterly installments over the life of the loan. Our rate of interest on these borrowings is equal to 2.5% plus a greater of LIBOR or 75 basis points.

Our current interest rate will be approximately 3.25% plus an additional 25 basis points for amortization of financing costs. As with any acquisition, we calculate the fair value of the assets and liabilities as at the date of acquisition. This typically results in purchase price adjustments from what their closing balance sheet shows to our opening balance sheet. We expect evaluation to take 2 to 3 months to complete.

Notwithstanding, I want to give you some guidelines of what you might expect with regard to deferred revenues and deferred costs. I will refer you to slides that we posted in the Q2 investor presentation in the Investor Relations section of our website under the heading GXS Deferred Costs and Deferred Revenue.

The nature of managed service arrangements, in most instances, requires initial work to set up a customer on the platform. This work can take several weeks, and the customer will typically pay a fee for that set up. The benefit of the set up, however, is earned over the entire contract period; so the revenue associated with this is recognized over the initial life of the contract.

The corresponding costs associated with this arrangement are also deferred and amortized over the same term. Where all of the initial setup work is complete, the fair value of these deferred revenues and costs will be zero and effectively written off under purchase price accounting. Please refer to the slides for a more detailed review of this.

And, again, note the figures provided are based on preliminary estimates, and the final adjustments will differ. The illustration shows that approximately $6 million of deferred cloud services revenue and $6 million of deferred cloud services costs would not be recognized in our combined financial operations for the balance of fiscal 2014.

Deferred revenues for maintenance revenue on software contracts are also subject to purchase price accounting. Any adjustment resulting from fair valuing this amount is more typical of what you've seen in previous acquisitions of software businesses in that there will be a writedown in the range of 20% to 30% of the balance on the closing balance sheet.

The range of this amount and the timing of the impact over the next four quarters is also estimated in the reference slides. Based on an initial review, we estimate the range of the writedown could be between $5 million to $8 million, with 70% to 80% of that impacting the second half of fiscal '14 and will reduce customer support revenue. Note again the examples we provided are estimates based on previous periods.

As I mentioned, we will complete the valuation work in this quarter and will be in a position to provide the final numbers when we report our Q3 results. The purpose of providing estimates at this time is to inform our investors of how these would affect future revenue and expenses apart from the normal business activities and results.

Consistent with expectations for acquisitions of this size, concurrent with the acquisition of GXS, we effected a workforce reduction of approximately 4% of the combined workforce after which there are approximately 8,200 employees for our combined companies. These reductions were done across both companies and all functional areas. We believe the reductions will not negatively affect operations.

The cost of these actions will be in a range of $11 million to $15 million and will be reported as specialty charges in the current quarter. We also plan future reductions through fiscal 2015 due to synergies from combining the operations of GXS and OpenText. We expect to incur additional restructuring charges of approximately $7 million to $10 million for personnel, $9 million to $11 million for facilities, and other restructuring charges of $2 million to $3 million.

By next quarter, I will update these numbers and estimated timelines as we finalize our plans. We expect that GXS will be immediately accretive to adjusted earnings as we previously defined. Based on the actions taken and planned, we believe that we will have GXS and OpenText operating margin by the end of fiscal 2015. We have also updated our target model for fiscal 2014 for the addition of GXS.

This is posted on our site in our Q2 investor relations presentation. In this update we show that previous 2014 target model and the updated 2014 target model, including GXS, as well as the target model for the second half of fiscal 2014.

We expect the range of our non-GAAP adjusted operating margin to remain the same at between 27% to 31% for 2014. Now, I'll turn the call over to Mark.

Mark Barrenechea - ***OpenText Corp - President and CEO***

Thank you, Paul; and welcome, everyone, to our fiscal 2014 Q2 earnings call. There are four main topics I'm going to speak to today: our business model, our product line up, fiscal 2014 Q2 results, and our GXS initiatives.

Let me start with the business model. We are focused on creating value for our stakeholders. We do this by growing our net income and our cash flows, through our dividend program, and onboarding acquired assets to our operating model. We do these while investing in innovation and in the markets we know we can win in.

We lead with value and we invest for growth. We don't chase growth at all costs; rather our operating principles are aligned to creating tangible and sustainable value. I have called this approach intelligent growth. For some businesses, acquisitions are either opportunistic or strategic. For OpenText, acquisitions are core to our business model.

We have created our EIM platform through acquisitions. We advance our acquired technologies through the innovation of features, modules, and integration. I highlight in my keynote at Enterprise World that Red Oxygen now has over 350 points of integration.

Consider our EIM platform. In ECM, we have acquired IXOS, Odesta, and Hummingbird. In CEM, we acquired Vignette, Artesia, and StreamServe. In VPN, we've acquired Global 360, Metastorm, and Cordys. In Discovery, we've acquired Nstein and Hummingbird. And in IX we've acquired Captaris, EasyLink, and now GXS.

Over the last 20 years, we have completed 48 acquisitions and put $3.4 billion in capital to work. Over the next five years, while working within our current leverage ratios and cash availability, we conservatively estimate $3 billion in acquisition capacity.

As Paul mentioned, on January 16th we completed the GXS acquisition with places us in the clear leadership position for information exchange. Consistent with our best practices on day one, we functionally integrated the GXS business as well as combining it with EasyLink. GXS calendar year 2012 full-year revenues were $488 million with adjusted EBITDA of $146 million.

We expect to onboard GXS to our operating model by the end of fiscal 2015. This is sooner than previously discussed.

We conducted day one employee reductions consistent with our financial goals and expectations for such an acquisition. We expect the business to be immediately accretive on an adjusted basis.

In addition to Paul's accounting statements, we expect flattish revenues; but we also need to take into account short-term any potential slight declines as we integrate the business. We have factored all these elements in into our 18 month onboarding model. Our business model includes our quarterly cash dividend program. Today we announced a two-for-one stock split by means of a stock dividend.

The record date for the dividend is February 7, and the payment date will be February 18. OpenText has undertaken the stock split to make our common shares more readily accessible to individual shareholders, increase and broaden OpenText shareholder base, and improve liquidity of the market for OpenText common shares.

Let me also comment on the recurring nature of our revenue. We have updated today our target model to reflect GXS; and you'll note that our combined service businesses, maintenance, PS, and cloud services, would account for 80% to 85% of our revenues. We consider these revenues to be highly recurring.

Recurring revenues drive stability, operational opportunities for greater efficiency, and long-term value.

Let me summarize my comments on our business model. Acquisitions are core to this model. GXS is now part of OpenText.

Day one actions complete, onboarding to our operating model by end of fiscal 2015, immediately accretive to adjusted earnings; quarterly cash dividend program, today's stock split by means of a stock dividend; and we put $3.4 billion of capital to work over the last 20 years; and we have a conservative estimate of $3 billion in gross acquisition capacity over the next five years; and 80% to 85% of our revenues are highly recurring. Our intelligent growth business model is working and gaining strength.

Let me transition to the second topic today, which is our product line up. As we enter calendar year 2014, our product line up has never been stronger with product Red Oxygen, AppWorks, managed services, and now the grid.

Guiding principles for our product Red Oxygen included synchronize releases of products, large new functional blocks, deeper integration and better packaging through suites of software. Content suite, information exchange suite, and our new developer platform AppWorks or [hga], tempo suite, experience suite, process suite, and discovery suite are all on track. Content suite includes our new archive server in the cloud, advanced records management, and a stronger user experience.

With information exchange suite, we deliver secure messaging across fax, e-mail, and notifications. With AppWorks, we are delivering on our vision of a unified platform with our restful APIs across our suites. AppWorks is our new developer platform that allows web developers to create new applications, screens, and workflows on top of our EIM suites using popular scripting languages like JavaScript.

AppWorks opens up OpenText with our EIM suites to every web developer on the planet. It transforms the web nature of enterprise application development. No longer does it take months to build the new module or enterprise app. With AppWorks, developing a new module or enterprise app can be prototyped in days.

With AppWorks we look to help enterprises re-platform, not only with a comprehensive EIM platform on the backend but on an entirely new class of mobile and social applications on the front. Further, we are recruiting and building our developer network and community with our new OpenText developer network. Over the last 90 days, we have enabled 160,000 active users for AppWorks in our developer network; and we are only just getting started.

Process suite delivers our unified BPM user experience, deep social integration, and new case management platforms integrating Cordys BPM with Case 360 and MBPM. Experience suite delivers a new user experience for media management, adaptive Omni channel content delivery, and deep integration with e-commerce solution providers including SAP Hybris.

Discovery suite includes a new CIO dashboard and new semantic search enhancements. And finally, our new Tempo suite unites tempo box, tempo social, and our new tempo note into a complete solution for enterprises looking for secure, compliant file sharing in the cloud with integrated social collaboration and employee productivity tools.

Red Oxygen is our opportunity to engage with all our customers and drive upgrades and new sales. At the Enterprise World conference this past November, we hosted nearly 2,500 customers and partners to introduce Red Oxygen; get customers on the upgrade path; and enable cross-sell of each of our suites, leveraging our deep integration and common developer platform.

Interest coming out of Enterprise World is high. Let me highlight a Q2 win, an EIM unlimited deal driven by Red Oxygen. Home Trust entered into a multi-year unlimited deal to support their enterprise digital strategy. Home Trust will be leveraging Red Oxygen across new initiatives in mortgage servicing, mortgage origination, retail banking, customer experience, records management, and compliance.

Let me transition to the cloud.

With the combined GXS managed services and OpenText managed hosted environments, we are now 700 customers strong running their businesses in the OpenText cloud. We are going to call this combined going forward managed services. This is an area of focus and growth for us in the future. Some of the recent wins include Barclays, Deutsche Bank, [Pases Del], Henkel, and a world leading silicon manufacture.

We have a long-term strategic opportunity to bring customers into the OpenText cloud and manage our customer's EIM and BPM platforms. To round out products, let me speak to messaging services or the grid. Customers will be very excited about our bringing together the messaging services from EasyLink and GXS.

The EasyLink grid, called XDDS, is a world leader in fax and notifications. The GXS grid, called trading grid 13, or TG 13, is a world leader in EDI and B2B. Together, we enable 16 billion business-to-business transactions a year; 600,000 trading partners; and over 50,000 customers.

We are driving to be the world's largest business network. Look no further than the Gartner top supply chain companies to see the long-term opportunity for OpenText. Together, we have a footprint at 10 out of the top 10 supply chain companies in APAC, 14 out of the top 15 EMEA, and 22 of the top 25 globally. Our product line has never been stronger for our sales force and our partner network.

Let me speak about the third topic today, the quarter. Q2 was very active with our GXS announcements, record attendance of customers and partners at Enterprise World, project Red Oxygen while delivering solid results. Let me provide a few highlights.

Revenues were up year over year by 3.2% to $363 million, and licenses were up 7% year over year to $81.2 million. Quarter over quarter, revenue was up 10% and licenses was up 47%. Quarter over quarter, adjusted operating income was up 13.2% and adjusted earnings was up 15.3%. First half to first half comparisons, adjusted operating income is up 17.4%, and adjusted earnings were up 3.1%.

Within Q2, EMEA and customer support contributed to our revenue and license growth. We also had a very good BPM quarter.

Financial services contributed 22%, services 17%, government 14%, consumer goods 10%, technology and materials each at 10%. There were 6 license transactions over $1 million and 15 transactions between $500,000 and $1 million.

Customer successes in the quarter included Home Trust for an EIM unlimited; Insurance Corporation of British Columbia; Owen, Illinois, and Chicago Federal Home Loan Bank; [CZED] Insurance from the Netherlands; and MMM Group for ECM; Fox Entertainment Group and Cutter University for CEM; and Sobeys, iGate, CHCS, and [Floor] for BPM. 59% of our business was direct and 41% partner influenced.

Let me transition to GXS. Our way forward remains EIM, smarter and collaborative content with ECM, smarter process application for BPM, smarter customer experiences with CEM, analytics and search with discovery, and smarter transactions and digital supply chains with information exchange.

GXS is a leader in B2B integration services. Some call it EDI; some call it B2B integration. We call it information exchange. In all cases, it's the engine room for commerce. This is where companies manage the digital supply chains with their trading partners to exchange information such as product catalogs, inventory reports, purchase orders, shipment notices, payment instructions, and security trades electronically.

The majority of GXS products are delivered on a causeway platform called the trading grid. We have now merged our GXS and EasyLink teams on day one of the acquisition. We think digital supply chains across key industries enabled by vertical application will drive value for customers at OpenText.

We believe that the combination of these assets will create three long-term growth opportunities. First, is in creating the world's largest business network. We will stay focused on this by growing services, applications, and trading partners on our trading grid.

Second, managed services and cloud-based EIM platforms. The fastest-growing part of GXS has been managed services. Our combined professional services organization will be over 2,000 EIM experts strong helping customers enable their information and B2B platforms.

Our services organization is world-class and a strategic differentiator. We believe that this model and the GXS platform can be extended to broader OpenText EIM suites to offer cloud-based enterprise content management, customer experience management, and discovery solutions.

Third, is a portfolio of [verta] collapse. GXS brings a portfolio of staff applications to enable business processes ranging from product catalog exchange and order taking to its electronic invoicing and cash management. We believe that there are number of synergies between GXS's applications and OpenText products.

For example, GXS processes a cloud-based service for tax compliant e-invoicing in over 40 countries, which can be paired with OpenText's vendor invoice management application to provide a complete solution for accounting organizations. These services are mission critical to business.

Without these services orders would stop, shipments would get lost, invoices would go unpaid, cash would not move, transportation would halt. These services are constantly changing with new product introductions, new procurement teams, new exchanges in integration and technology standards, ERP upgrades, new trading partners, and industry consolidation.

Our immediate go-to-market opportunities include cross-selling GXS and EasyLink services; selling more managed services across all products and all Geos; providing GXS sales coverage in countries where they lack the scale, examples include Canada and Brazil; enabling new services on the grid such as capture, BPM, archive and vendor invoice management. We believe these programs would drive new customers and network traffic.

To summarize on GXS, in addition to Paul's accounting statements, we expect flattish revenues; but we also need to take into account short-term any potential slight declines as we integrate the business. Two, we expect to onboard GXS to our operating model by the end of fiscal 2015. This is sooner than previously expected.

Three, we conducted day one employee reductions consistent with our financial goals and expectations of such an acquisition. Four, GXS and EasyLink operations have now been combined. And, fifth, we expect the business to be immediately creative on an adjusted basis. There are clear identified paths for growth.

Let me provide my final prepared remarks for today, and then we'll go to Q&A. I am proud of the OpenText team and our 8,200 professionals. What I see everyday from inside the company is their passion for customers' and our stakeholder's success.

Our progress includes license growth of 7% year over year and 47% quarter over quarter; completion of combining GXS with OpenText and day one integration; our quarterly cash dividend program; our announced two-for-one stock split; project Red Oxygen; over 700 managed services customers now; a drive to creating the world's largest business network; and a solid product lineup as we enter calendar year 2014 with our EIM suites, AppWorks for the developer, managed hosting in the grid with clear priorities to drive growth. Without a doubt, our best days are firmly ahead of us. With that, I'd like to open the call to your questions.

QUESTION AND ANSWER

Operator

Richard Tse, Coremark Securities.

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

Thank you, very much. Mark, could you elaborate a little bit more on the potential revenue synergies with GXS? I guess, specifically, I'm curious to see of the existing customers that OpenText has, how many are currently running transactions through GXS? Or maybe from a percentage basis, what that number would be?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Yes, Richard, thanks for the question. Look, I think the -- when I think of the revenue, the growth opportunities, the first is bringing EasyLink services to GXS customers and bringing EDI to EasyLink customers. The customer overlap, roughly, is 20% to 25% between the two installed bases. So, a significant portion of the customers do not overlap.

Second, is filling out applications. We have world-class OCR capture and vendor invoice management. These are more horizontal apps to add to their portfolio. And then, operationally we can certainly help GXS in places where they don't have scale where we do like Canada, Germany, to name a few.

So, there's lots of white spaces in the install base. Natural synergies between GXS and EasyLink to sell both ways. New horizontal applications that are at the ready from the OpenText portfolio. And then, just operationally more geo coverage and two clear examples are Canada and Germany.

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

Okay. And then, just one other quick question with respect to the $3 billion acquisition capacity. Given that you're in the mist of integrating this is it safe to say that we are not going to see a sizable deal until this is complete or is that something you can take on still for the rest of this year?

Mark Barrenechea - ***OpenText Corp - President and CEO***

I think consistent with previous commentary on acquisitions, I won't get into timing or pillars or markets. I would say for the most part, though, this acquisition is going very deep, right within one of our five market pillars. We will reserve remarks for the timing and geos and pillars. But, I do look at the previous 20 years of 48 acquisitions and $3.4 billion of capital to work in over the next five years conservatively, we see another $3 billion we could put to work.

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

Okay, great. Thank you.

Operator

[Panos Mishopolis], BMO Capital Markets.

Panos Mishopolis - ***BMO Capital Markets - Analyst***

Hi, good afternoon. Mark, can you talk a little bit about what you saw from a geographic perspective? I think you mentioned EMEA was strong, looks like the Americas was flat year-over-year. Can you elaborate on that and how the environment is looking currently?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Yes, it's a fine question. We -- I think there's some stability that we've started to see in EMEA. Over the last few quarters, discussions of the Euro, who is leaving the union and who's not has faded and some confidence has, that we can see, has returned.

And, I think the term cautiously optimistic is quite appropriate for EMEA at this point. We're also executing -- we also executed well in our EMEA emerging market strategy in South Africa, Eastern Europe, Middle East. So, we had a good quarter.

I think we had 11% growth in EMEA license. It was a good environment for us in Q2. In the US, certainly the dollar is getting stronger and I think confidence is returning a little bit to the US. I think that starting to flow into conversation but hasn't fully translated into revenues yet.

Panos Mishopolis - ***BMO Capital Markets - Analyst***

Okay. And, can you talk about what you're seeing as far as Red Oxygen both in the quarter and in the pipeline? You singled out a specific deal that closed in the quarter drive by Red Oxygen. Was that really a benefit in the quarter or is that more from pipeline perspective what we're going to see going forward?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Yes, I'm just highlighting one. We have closed, certainly, a handful of Red Oxygen deals within Q2. And, 50% suites are live and the other 50% will go live this quarter. It is a major product cycle for us. It's an opportunity to go out and speak to our entire install base.

To upgrade them from whatever release they were on, one release, two release, three releases back, to have our field and support organizations reengage with the install base, drive upgrades, and drive new module sales. So, Red Oxygen is for sure a catalyst for us to drive a lot of activity for many, many quarters.

Panos Mishopolis - ***BMO Capital Markets - Analyst***

Great, thanks. I'll pass the line.

Operator

Scott Penner, TD Securities.

Scott Penner - ***TD Newcrest/Waterhouse Securities - Analyst***

Thanks, Mark, just two questions. First of all, I wanted to ask about AppWorks. It seems like a really exciting opportunity. I wanted to see if you guys had quantified exactly what that could add to your overall market opportunity? And then, as far as driving developer licenses, or license to the foundation elements, is this a second half of 2014 event or is it more like fiscal year '15?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Fair enough, it's a great question. EIM is still a young market. One of the reasons that drove us very hard to modernize our developer platform and to modernize our core suites so they can be accessible through modern languages and done in an innovative way so you can build apps very quickly, was the fact that we recognize that our customers are still building, in significant volume, custom applications.

Many parts of our sales cycles compete against custom development. In fact, it's one of the reasons people pick SharePoint is that it's easy to write C code or Java code on top of SharePoint. So, we put a lot of energy behind delivering AppWorks and putting a services layer on top of our platform.

We also feel we need to build a broader ecosystem as part of our metric capital strategy that we announced earlier in the week with the government of Canada as well as the OpenText enterprise application fund, both of which we'll be minority and investors in.

The revenue opportunity, certainly our developer licenses, but if you're writing code you also, when you go to production, have to buy the suites and then begin to deploy the suites. So, the largest revenue opportunity is actually deploying our core suites once you build an App on top of them. Which I would think would be a greater contributor in fiscal '15.

Scott Penner - ***TD Newcrest/Waterhouse Securities - Analyst***

And then lastly, Paul, a quick one. Just how should we view the priorities for capital allocation now? And, how quickly, or not quickly, is your preference to pay down the debt?

Paul McFeeters - ***OpenText Corp - CFO***

I think we're quite comfortable, Scott, right now in the net leverage on our balance sheet. I don't think the -- our first use of cash will be to accelerate any repayment. As you know, with a term loan A we have mandatory repayments presently at 7.5% over the next two years.

And then, 10% before the term comes due. So, I think with that you'll see, obviously, us conform to those repayments. Accelerating beyond that is unlikely because of the opportunity we would have for future acquisitions with the cash

Scott Penner - ***TD Newcrest/Waterhouse Securities - Analyst***

Okay, thank you

Operator

Paul Steep, Scotia Capital.

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

Great, thanks. Mark or Paul, maybe you could talk about the acceleration? You pulled things forward by about six months, maybe what's changed? And then, also give us a perspective on how we should think of it, the GXS organization? This is one of your biggest deals ever. And then, I've got one quick follow up, thanks

Paul McFeeters - ***OpenText Corp - CFO***

Yes, Paul, I'll start with the [cause] side. We've done this, probably, every time. I'm not sure -- we really haven't really moved up the synergies in the sense that we just done a reduction in force across both entities, across many functions.

So, as I mentioned, then, as we really benefit from synergies we'll continue to see that in our operating results. I'm really separating the two. We just simply did our reduction first.

Mark Barrenechea *- OpenText Corp - President and CEO*

Yes, fair enough. Let me just provide a couple comments as well. When we were doing our initial planning we looked at two years. But, once we were able to get to the right stage and look deeper, we found path to bring that into onboarding into out model within 18 months.

And look, consistent with our best practices and experiences, the faster you can go in integration, the better you are short-term and long term. When you have two of everything I encourage teams to take an adopt and go strategy and not invent a third.

Whether it be a process or a team or some activity, you have got two of something, they're both good, pick one adopt it and go. So, bringing together over 8,000 employees we found path to reducing employee base by about 4% and doing that on day one and integrating quickly.

Paul Steep *- Scotiabank - Analyst*

Okay. Two last -- one last clarification on that and then another one. Just on the sales force alignment, is there any changes we should expect there, Mark, in terms of merging together those forces or are they going to actually stay distinct?

And then, the second clarification on your earlier comments in the call, in terms of revenue decline, historically on license I think we had been guided to maybe 20% down at the max. What's the thought around cloud in terms of the magnitude there? Thanks.

Mark Barrenechea *- OpenText Corp - President and CEO*

Fair enough. On the sales force, we have brought together the GXS and EasyLink sales forces. George Schultz, world-class sales leader from the GXS team, is leading the combined field organization. George will report directly into John Hunter.

George is a world-class individual, a lot -- an amazing amount of experience. And, he's taking over both GXS and EasyLink go-to-market reporting to John directly. And, John's off to just a wonderful, fast start inside the organization.

Yes, on the license side, we have typically guided down and that's the license business. But, given this is recurring revenue we don't see those type of declines at all. As Paul obviously went through the purchase price accounting adjustments that he's -- that our -- it's accounting, if you will.

And then, we are expecting revenues to be flattish as we come out of the gate except for some potentially slight declines hear in the short-term depending on how well we do on the integration. So, on a recurring base, the clients would be nothing near this. There's the accounting affect that Paul walked through. We have some potential slight declines on a flattish business just as we bring the two together.

Paul Steep *- Scotiabank - Analyst*

Perfect. Thanks, guys

Operator

Paul Treiber, RBC Capital Markets.

Paul Treiber *- RBC Capital Markets - Analyst*

Thanks, very much. Two quick ones on the financials. One is with the addition of GXS do you anticipate any change to your target tax rate? And then, also, what was the foreign-exchange impact to revenue in the quarter?

Paul McFeeters - ***OpenText Corp - CFO***

Yes, Paul, in terms of the tax rate for this fiscal year, no, I update tax rates annually but I don't see a change for the current fiscal year. We have not provided constant currency revenue adjustments. But, I can tell you that for licenses it was slight for CS, I have mentioned that before, it impacted it by about 1% to a benefit.

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

Okay, thank you. And then, one for Mark on the strategy and the longer term view. After GXS, the cloud or transaction revenue was about one-third of total revenue, so you are obviously making a big investment to address the cloud. How should we think about the license business going forward in terms of the perpetual model? Will you continue to sell license longer-term on a professional model or do you see that moving to SAS over time?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Paul, thanks for the question. No, the license business remains important. I certainly emphasized recurring revenues, which we like very much. Customers are placing workloads where they need to that are most effective for them.

Customers will continue to buy license at scale and in mass. Customers will place workloads in the cloud. We continue to envision a world that is hybrid, especially in the market that we serve which is the global 10,000 and top governments.

Cloud is a big term so one of the big strategies -- largest strategies we have is managed services where we want customers to bring their computers, their software, their data, our software, their data, our experts into our infrastructure so we can manage an advanced sales environment for our customers.

So, we continue to see customers buying license. And, in fact, they bought a lot of licenses last quarter at $81 million, 7% growth year-over-year, and 48% -- 47% sequential growth. The license business remains real important to us.

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

Okay. Thanks, very much. I'll pass it along

Operator

Michael Nemeroff, Credit Suisse.

Mike Anderson - ***Credit Suisse - Analyst***

Hi, guys, is Mike Anderson on behalf of Michael. Thanks for taking our questions and congrats on the nice quarter. Mark, I believe that you mentioned last quarter that your ASP was roughly 268,000 whereas this quarter it ticked up to 274,000. With the Red Oxygen suite strategy, can you give us a framework to think about how Red Oxygen has the potential to lift ASP over the next couple years as your customers may be more likely to purchase more of your EIM suite?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Mike, thanks for the question. It's a fair observation that as customers buy more of the suite the ASP should trend up. So -- and it should trend up over a variety -- over a course of many years as we sell more and more suites. There will be three layers to buying licenses.

Folks will buy-buy the product or, as folks like to say, buy the drink. Folks will buy-buy the suite, or buy the bottle, or they may buy the whole unlimited, which is buy the case. But, I'd expect to sell more -- be feathering in suite sales which should drive up the ASP.

Mike Anderson - ***Credit Suisse - Analyst***

Great. And then, of the large deals that you did close this quarter between $500,000 and $1 million and $1 million plus, can you give us an idea of what percentage of those deals were Red Oxygen related? And then, with that, were the new Red Oxygen customers, did most of those come from the beta test group?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Thanks for the question. Look, I'm not breaking out the total number of Red Oxygen customers, but I will say Red Oxygen had a favorable impact in the quarter. Many time you come out with such a large release that has a broad impact across your install base it's going to have an effect. Is that a favorable effect within the quarter? Only 50% our suites are live right now, the other 50% go live at the end of the quarter, but it had a favorable impact.

Mike Anderson - ***Credit Suisse - Analyst***

Great. And then, just one quick housekeeping one. I think in your prepared remarks you said that there was 41% of license was partner and I think in the slides it says 35%. So, I just wanted to make sure I had my numbers right.

Paul McFeeters - ***OpenText Corp - CFO***

It is 35%.

Mark Barrenechea - ***OpenText Corp - President and CEO***

35%. My prepared remarks were -- had a typo in it.

Mike Anderson - ***Credit Suisse - Analyst***

No problem. Thanks, very much

Operator

Blair Abernathy, Cantor Fitzgerald.

Blair Abernethy - ***Cantor Fitzgerald - Analyst***

Thanks, very much. Just a question for you, Paul, on the GXS side, the last numbers that we've seen have been end of 2012. Can you give us a sense of has the run rate moved that much at the end of 2013?

Paul McFeeters - ***OpenText Corp - CFO***

Short answer, no.

Blair Abernethy - ***Cantor Fitzgerald - Analyst***

Okay. And, in terms of the reduction in force on the OpenText side I wonder if you could just give us a little more color there. Did you -- have you done anything on the sales force side? And, what is your thinking this year in terms of sales force capacity? Are you happy with where you are or is that going to change this year?

Mark Barrenechea *- OpenText Corp - President and CEO*

I'm sorry, Blair, could you repeat the question?

Blair Abernethy *- Cantor Fitzgerald - Analyst*

Just in terms of -- just a little more color on the reduction in force on the OpenText side?

Mark Barrenechea *- OpenText Corp - President and CEO*

Yes, we looked at overlapping functions as we were going to integrate the two businesses. That was a primary nature of other reductions across all organizations, across all functional lines. We are doing well on hiring, our turnover rate remains, in the sales force, at industry levels. So, nothing out of normal bands.

Blair Abernethy *- Cantor Fitzgerald - Analyst*

Okay, great. And then, Paul, in terms of revenue reporting next quarter with the GXS, will 100% of the GXS revenue be in your cloud services line or is there some revenue that will be moving into other categories?

Paul McFeeters *- OpenText Corp - CFO*

Yes, there will be some revenue that will be in license and maintenance.

Blair Abernethy *- Cantor Fitzgerald - Analyst*

Can you give us a sense of the magnitude of how much will be in license and maintenance?

Paul McFeeters *- OpenText Corp - CFO*

I want to be more accurate than I have right off the top. So, what I will do is I'll look at their disclosed information and if I can break that out I will and I'll put it in our -- up in our investor site if that's okay.

Blair Abernethy *- Cantor Fitzgerald - Analyst*

Sure, that would be great, thanks. Okay, that's it for me. Thanks, guys.

Mark Barrenechea *- OpenText Corp - President and CEO*

Thank you.

Operator

Mark Schappel, Benchmark Company.

Mark Schappel *- The Benchmark Company - Analyst*

Hi, good evening. Mark, in the past I believe you've probably talked about maintaining product growth at or about the market growth rates. With the exception of GXS I'm wondering if you're still holding to that general growth rate for the core business?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Look, you have to continue to target the industry rate. I don't know what else to target. So, we -- when we're looking at the Gartner data and we've updated our -- not updated but it's in our investor deck, and I'm looking at it right here I think it's Slide 11, it talks about the Gartner data across the five colors. Their reporting roughly 11.4% CAGR between 2012 and 2017. So, the programs, the investments we're driving at is still the -- a drive at the market rate.

Mark Schappel - ***The Benchmark Company - Analyst***

Okay, thank you. And then, Paul, real quick, you may have mentioned this but the Cordys revenue in the quarter, do you have that handy?

Paul McFeeters - ***OpenText Corp - CFO***

We're not ready to say.

Mark Schappel - ***The Benchmark Company - Analyst***

Thank you

Operator

Rakesh Kumar, SIG, Susquehanna Financial Group.

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

Great, thank you. I believe at the conference last year you talked about [people to] Cordys, BPM, and platform. And, I just wanted to understand if that's credit and if yes, I wanted to understand your strategy for the BPM segment. And, could there be any potential disruptions in the field?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Rakesh, thank you for the question. Cordys is our lead go-to-market platform for sure. The opportunities we see are continuing to provide a business process orchestration layer which Cordys is extremely strong on. Second, is a set of libraries and developer tools, on top of that orchestration layer, to build smart process applications.

Third, is delivering a set of our own applications such as case and contract management deeply integrated to other pillars. Especially document centric or content centric applications, so integrating to ECN. We envision our own app layer, our developer tools and libraries that help customers build enterprise apps that need deep integration and then our process orchestration layer.

Those are the three key go-to-market pushes that we have and Cordys is our lead. We had a good BPM quarter. We had a good BPM quarter and Cordys certainly contributed to that.

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

Just a quick follow-up. I was hoping you could talk about customer interest in pipelines for Red Oxygen? And, also when should we expect Red Oxygen to be fully GA?

Mark Barrenechea *- OpenText Corp - President and CEO*

Red Oxygen across everything, even through the tempo suites, will be GA -- fully GA in 90 days or less. So, that's, for the most part, say by the end of this quarter. We're about 50% live and the other 50% next 60, 90 days. Hopefully, everything by the end of the quarter.

And, our pipeline is up. We came into the quarter and the pipeline was stronger than the previous quarter. And, Red Oxygen, again, gives us the opportunity to go back into our install base and have, really, a very broad discussion around if you're on previous version, or two or three versions back, to -- our sales force has a variety of tools incent customers to come forward.

To go forward with a module upgrade. That module upgrade to other modules, upgrade to a suite. So, part of the design characteristic behind Red Oxygen was to give the field a broad tool to reengage the install base, which they now have. And, we expect it to be a catalyst throughout the coming quarters.

Rakesh Kumar *- Susquehanna Financial Group - Analyst*

Thank you.

Mark Barrenechea *- OpenText Corp - President and CEO*

Thanks, Rakesh.

Operator

Kris Thompson, National Bank Financial.

Kris Thompson *- National Bank Financial - Analyst*

Thank you. Paul, maybe you could just talk about the GXS CapEx. It looks like it's hovered around 40% for the last couple of years. And, Mark, in there there's some capitalized software development. Could you maybe just highlight what a good run rate is going forward? And, maybe give an explanation of that software, the capitalized software development, please?

Paul McFeeters *- OpenText Corp - CFO*

Yes, Kris, Paul. Until we get closer to it, and maybe change this answer, is it looks like it will be the run rate in the next period, a year or so. The internal capitalized software is for the buildout of TG13. At the point that that is complete, the portion of the capitalized software attributable to that will not re-occur.

As I said, when we get the fiscal break down of that it will be more specific than that. So, I would think about it as continuing and also the internal capitalized software as billing out the grid.

Kris Thompson *- National Bank Financial - Analyst*

Okay, that's helpful. And, just on the income tax, I know GXS had over $0.5 billion of tax loss carry [towards], are you able to retain those on the change of ownership or are those going to go way?

Paul McFeeters *- OpenText Corp - CFO*

They don't necessarily go away. Unfortunately, on acquisition the use of those losses are very restrictive. The small percentages offset against otherwise taxable income

Kris Thompson *- National Bank Financial - Analyst*

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Got it. Thanks, guys, great quarter

Mark Barrenechea - ***OpenText Corp - President and CEO***

Thanks, Chris

Operator

Eyal Ofir, Clarus Securities.

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

Thank you, and thanks for taking my question. Congrats on the quarter by the way. First question is just on last quarter, the license revenue was a little bit weak due to the government shutdown. I just wanted to get your impression, were you able to close some of those deals that slipped? And, how much of that helped in the quarter? And then, also I have another follow up on Red Oxygen.

Mark Barrenechea - ***OpenText Corp - President and CEO***

Eyal, thanks for the question. I'd say on the government side, I'd say North America -- I'll start with North America, North American government, conversations are -- buying conversations are more frequent today but it hasn't flowed through into revenue.

But, conversations are re-engaging but it hasn't gotten through all the way through the pipeline to close into revenue. We -- our public sector performance in Q2, which I think was about 14% of our revenues, were driven out of actually Asia-Pacific and EMEA and a lot of state and local wins that we had.

We had a good public sector quarter in Q2. But, it was mainly driven in Western Europe and Asia Pacific. But, I'll note in US and Canada conversations, as I said, are reengage for investment areas. But, hasn't worked all the way through to revenue yet.

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

Okay. So, we could see pent-up demand coming back there as well for future growth there. Another question for you, just on the Red Oxygen side. Obviously, when you come through into a new product cycle here the partners lag a little bit more than your direct sales force would.

What are your partners saying so far in terms of feedback providing you? And, also from a pipeline standpoint, what are partner showing you thus far and what do you expect going forward?

Mark Barrenechea - ***OpenText Corp - President and CEO***

Yes, I'd point to Enterprise World. I mean, we had record partner attendance. We go through end user training, went into our partner conference and get to the broad conference at Enterprise World. We just had record attendance on Monday.

It was the first partner conference we had that brought together all the pillars really into one room. All the pillars into one room. So, partners have a lot more opportunity today. They have more opportunity, should they grab it, to sell across pillars. So, partners and alliances are real important to us. We added about 20 new partners last quarter, primarily in our VAR business, value added resellers.

Hybris was a customer we talked about, a partner we talked about last quarter that we are investing in. And, SAP remains real strategic to us. It's our biggest, most important partnership that we have. We also expect our extended ECM for Oracle, we're on track for that to go GA in March which will open up an Oracle discussion as well.

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

Okay, perfect, thanks. Before I pass a line, just one for me. On the GXS front obviously you've put together your sales forces with EasyLink. When can we expect some of the -- your own OpenText direct sales force to be able to start up selling to GXS products and visa-versa.

Mark Barrenechea - ***OpenText Corp - President and CEO***

The immediate opportunity is for GXS and EasyLink sales forces to optimize what's right in front of them. We are keeping them real focused on what they own and going to perfect what they own. We do have what we call hunting licenses across the sales forces for leads in and opportunity selling. But, I'd say for the rest of this fiscal year we are going to be real focused on perfecting what's inside of GXS and EasyLink.

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

Okay, great. Thanks, and congrats on the quarter

Mark Barrenechea - ***OpenText Corp - President and CEO***

Thanks, so much.

Operator

Mr. Barrenechea, there are no further questions at this time. Please continue with any closing remarks you may have.

Mark Barrenechea - ***OpenText Corp - President and CEO***

All right, very good. Well, it was an important call discussing intelligent growth, GXS, and our strong Q2 results. We will be presenting at the Morgan Stanley investor conference in San Francisco on March 5 and we hope to see you there. So, thanks for joining us today. That ends today's call.

Operator

Ladies and gentlemen, this concludes the OpenText Corporation's second quarter fiscal year 2014 results conference call. Thank you for your participation. You may now disconnect.