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OTC.TO - Q3 2014 Open Text Earnings Conference Call

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OVERVIEW:

OTC.TO reported 3Q14 total revenues of $442.8m and GAAP net income attributable to Co. of $45.9m or $0.38 per diluted share.

CORPORATE PARTICIPANTS

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Thanos Moschopoulos *BMO Capital Markets - Analyst*

Scott Penner *TD Newcrest - Analyst*

Blair Abernethy *Cantor Fitzgerald Canada - Analyst*

Richard Tse *Cormark Securities - Analyst*

Stephanie Price *CIBC World Markets - Analyst*

Paul Steep *Scotia Capital - Analyst*

Paul Treiber *RBC Capital Markets - Analyst*

Eyal Ofir *Clarus Securities - Analyst*

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the OpenText Corporation third-quarter FY14 results conference call.

(Operator Instructions)

I would like to remind everyone that this conference call is being recorded today, Thursday, April 24, 2014 at 5 PM Eastern Time. I will now turn the conference over to Mr. Greg Secord, Vice President, Investor Relations. Please go ahead, sir.

Greg Secord - *OpenText Corporation - VP of IR*

Thank you, Ron, and good afternoon, everybody. I'd 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 that contain forward-looking information.

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

Additional information about the material factors that could cause actual results to differ materially from 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 the future performance results of OpenText, are contained in OpenText's Forms 10-K and 10-Q, as well as in the 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's President and CEO, Mark J. 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 have posted an updated PowerPoint that will be referred to during the call, as well as a summary table highlighting OpenText's historical trended financial metrics. And with that, I'll hand the call over to Paul.

Paul McFeeters - ***OpenText Corporation - CFO***

Thank you, Greg. Turning to the financial results, I will highlight our third quarter of FY14. Total revenue for the quarter $442.8 million, up 31% compared to $337.7 million for the same period last year. Regionally, the Americas contributed 54%; EMEA, 36%; and Asia-Pacific, 10%.

License revenue for the quarter was $73.1 million, up 6% compared to $69 million reported for the same period last year. The acquisition of GXS contributed $1.1 million of license revenue this quarter. We saw license revenue broken down by vertical sector as 20% from public sector; 18% from services; 14% from technology; 13% from basic materials; 12% from financial services; 9% percent from healthcare; 6% from consumer goods; 6% from industrial goods; and 2% from utilities.

Cloud services revenue for the quarter was $128.4 million, up 197%, compared to $43.2 million in the same period last year. Cloud services gross margins were 61.5% in the quarter compared to 56.6% for the same period last year. The acquisition of GXS contributed to $88.2 million of cloud services revenue this quarter; the increase in cloud services margin was primarily due to a reduction in telecom costs.

Customer support revenue for the quarter was $180.3 million, up 8% compared to $166.6 million in the same period last year. Customer support gross margins were 86% in the current quarter compared to 83.5% for the same period last year. The acquisition of GXS contributed $5.8 million of customer support revenues; the increase in customer support margins was primarily due to a reduction in third-party technology costs.

Professional services and other revenue for the quarter was $61 million, up 4% compared to $58.9 million in the same period last year. The professional services gross margin was 19.3% in the current quarter versus 15.6% for the same period last year. The increase in margins was primarily the result of the reduction in labor-related expenses in the quarter compared to the same period last year.

Gross margin for the quarter before amortization of acquired technology and stock compensation was 71.3% compared to 70.8% for the same period last year. Pre-tax adjusted operating income before interest expense and stock compensation was $129 million this quarter, up 42.7% compared to $90.4 million in Q3 of the last fiscal year.

Adjusted net income increased by 38.2% to $102.6 million this quarter, up from $74.2 million in Q3 of last fiscal year. Adjusted earnings per share is $0.84 per share on a diluted basis, compared to $0.63 for the same period last year, up 33%. The sequential effect of foreign currency movement on adjusted earnings per share for Q3 was a positive $0.03. The adjusted tax rate for the quarter was 14%, same as it was last fiscal year.

On a GAAP basis, income from operations before interest and taxes for the third quarter was $66.8 million, up 63.6% from $40.9 million in the third quarter last year. GAAP net income before taxes was $58.8 million in the current quarter versus $37 million in the same period last year. Net income attributable to OpenText for the third is accordance with GAAP was $45.9 million or $0.38 per share on a diluted basis compared to $25.8 million or $0.22 per share on a diluted basis the same period a year ago.

Operating cash flow for the quarter was approximately $141 million, an increase of 21% compared to $117 million in the same period last year. Excluding the impact of special charges, operating cash flow for the quarter was approximately $151 million, compared to $122 million in the same period last year.

There were approximately 122.1 million shares outstanding on a fully diluted basis, post-stock split for the third quarter of FY14. This reflects an increase of approximately 2.6 million shares issued as part of the equity consideration for the GXS acquisition.

On the balance sheet, at March 31, 2014, deferred revenues were $352 million compared to $294 million as of June 30, 2013 and $308 million as at March 31, 2013. The acquisition of GXS contributed approximately $34 million to the deferred revenues balance as of March 31, 2014.

Accounts receivable was $257 million at March 31, 2014 compared to $175 million at June 30, 2013 and $175 million March 31, 2013. Days sales outstanding were 52 days at March 31, 2014 compared to 45 days as of June 30, 2013 and 47 days as of March 31, 2013. The slightly higher DSO in the current quarter was on account of the acquisition of GXS.

During the quarter, we acquired GXS for approximately $1.2 billion, inclusive of equity consideration of [$116] million. As part of the purchase price allocation, we allocated approximately [$488] million to intangible assets, acquired and recognized approximately $838 million of goodwill.

On March 31, 2014, our headcount was approximately 8,100, comprised of 1,900 in R&D; 2,100 in cloud services; 700 in customer support; 1,000 in professional services; 1,400 in sales and marketing; and 1,000 in G&A. Overall, our headcount increased by approximately 3,000 employees on account of the acquisition of GXS.

As mentioned in the Q2 earnings call, we've updated our target operating model for the acquisition of GXS and this model is posted on our website in the Investor Relations section. Our range for non-GAAP operating margin continues to be 27% to 31%.

In connection with the post-acquisition accounting for GXS, we had to make certain fair value adjustments to the carrying value of deferred revenues and deferred implementation cost acquired from GXS. The pro-forma income statement impact of these fair value adjustments has been included for reference as part of the Q3 investor relations presentation posted on our website. This guidance updates and supersedes the guidelines we have provided on this matter in our Q2 investor presentation.

In Q3, the pro-forma income statement impact of the fair value adjustment to deferred revenue and deferred cost was a $3.8 million increase in cloud services revenue and a $0.9 million decrease in maintenance revenue and a decrease in deferred implementation expenses of approximately $2.8 million, resulting in a pro-forma net income charge of approximately $1.9 million. As indicated by us in Q2, we expect to onboard GXS to our operating model by the end of FY15.

During Q3, we commenced implementation of the restructuring plan to reduce workforce and rationalize facilities within the combined OpenText-GXS Organization. As part of these actions, we booked specialty charges of approximately $12 million during the quarter, of which approximately $4 million was paid out in Q3 in cash. As part of this initiative, we expect to incur additional restructuring charges in the range of $10 million to $15 million through FY15.

On April 24, 2014, the Board increased the quarterly dividend by 15% and declared cash dividend of $0.1725 per share for shareholders of record on May 23, 2014, payable on June 13, 2014. Today we filed a shelf registration statement on a Form S-3 with the SEC, which becomes effective immediately in the United States and we will shortly file a prospectus supplement. These filings satisfy the requirement to the [seller] shareholders of GXS, in particular, the approximate [$116] million of consideration in OpenText common stock. I'll turn the call over to Mark.

Mark Barrenechea *- OpenText Corporation - President and CEO*

Thank you, Paul, and welcome everyone to our FY14 Q3 earnings call. Q3 was an important quarter for OpenText, with the closing of GXS, delivering our major EIM suites, and our worldwide Innovation Tour. Innovation Tour 2014 brought us to Japan, China, Singapore, India, Australia, US, Canada, UK, Germany, France, The Netherlands, Switzerland, Sweden, and South Africa.

It was a great opportunity to connect with thousands of customers and hundreds of partners on GXS, our EIM suites, Managed Services and our new focused on the developer. The tour was focused on education and enablement of our products and solutions. It was a great tour.

Let me start today's call by highlighting five important areas. First, the team delivered stellar Q3 results. Year-over-year revenue was up 31%; cloud services was up 197%; license was up 6%; customer support was up 8%; professional services was up 4%. Adjusted operating income was $129 million, up 43%; adjusted EPS was up 33%; operating cash flow was up 21%.

Second, our strategy of intelligent growth is working and continues to gain traction. We deliver value through our business model of acquisitions, our financial and operating model, and by investing in innovation and markets we know we can win in. The operative narrative here is value, not growth at all costs as we see with other business models. We are raising our quarterly dividend by 15% to $0.1725 per common share, given the confidence in our Business.

Third, during the quarter, we completed our previously discussed workforce rebalancing, integrated the GXS business while onboarding over 3,000 employees, 40,000 customers, and 600,000 trading partners. The acquisition is working, off to a fast start, and we are on target to be on our operating model by the end of FY15, as Paul noted in his remarks. Q4 will be our first full quarter of operations and results and we have cross-sell and white space account opportunities and our combined road maps are strengthening. There is more value to unlock.

Fourth, we continue to strengthen our Company with revenues that are highly recurring. Consider, in the last seven quarters, we have onboarded approximately $600 million of annualized cloud-based revenues via our acquisitions of Easylink and GXS, while improving our margins, earnings, and our operating cash flows. We have emerged as a world-leading cloud services Company and we have chosen profitable revenues over a growth-at-all-cost business model. Within the quarter, our cloud services business is of near equal revenue scale to our license and professional services business, and we established this scale in less than two years.

Fifth, our major EIM suites, formally known as Project Red Oxygen, are now shipping, driving pipeline, and will be a leading growth driver in FY15. The Oracle and SAP versions are now GA as well. The final component, Discovery suite, begins shipping next week. I'll expand more on Project Red Oxygen later in the call.

It was an important quarter for OpenText -- stellar Q3 results; intelligent growth working; 15% dividend raise; GXS off to a fast start with more value to unlock; a focus on profitable, highly recurring cloud-based revenues; and shipping EIM suites. Let me get into Q3 with a bit more detail.

Total revenue was $443 million, up 31% year-over-year; Americas contributed 54%; EMEA, 36%; and APJ, 10%. License was $73 million, up 6% year-over-year. Our major EIM suites are now shipping, and in the coming quarters, will be the focus of driving pipeline, new sales, and upgrades.

[Consider full] Content Suite. We have approximately 300 customers now planning or in process, with the new 10.5 installer upgrade. Year-over-year Americas contributed 40%; EMEA, 46%; and APJ, 14%. We greater than 10% license growth from both EMEA and APJ. We had six license transactions over $1 million and our average license deal size was up to $307,000.

EIM suites should drive a larger license deal. 25% of license was from new customers and 45% of license was channel influenced. Although license is up 6% year-over-year, and as I have discussed on last earnings call, the Americas needs to contribute more, most notably US West and Canada. We completed our changes last quarter and I expect to see the Americas fully back on track over the next one the two quarter. Geographically, the Americas is our largest absolute opportunity.

Cloud services revenues were $128 million, up 197% year-over-year. Americas contributed 67%; EMEA, 21%; and APJ, 12%. As a reminder, cloud services consist of our managed messaging services and Managed Services; both are strategically important, but let me highlight our Managed Services.

We are now hosting over 725 customers in the OpenText cloud and we won 25 new accounts in the quarter. Some of those wins included T-Mobile, Invesco, and Alberta Energy. We have a multi-year opportunity to transition customers from EIM environments into the OpenText cloud and deepen our relationship with the world's leading companies. We had nine bookings over $1 million in cloud-based transactions.

Customer support was $180 million, up 8% year-over-year. All of our geographic regions at solid margin. Professional services was $61 million, up 4%. Americas contributed 47%; EMEA, 44%; and APJ, 9%. Year-over-year, we improved our margin. We had strong competitive wins; in the Americas, PBS, Alberta Energy, and Target; in EMEA, the Home Office, BP, the Western Cape local government, and GRTgaz in France; in APJ, the Malaysian government, Samsung, and AIA. Jon Hunter has been on board now for seven months, leading sales and services. His contributions are shining through and he is driving for growth.

Looking beyond revenue, our adjusting operating margin grew year-over-year from 26.8% to 29.1%. Our adjusted operating income was up 43% to $129 million within the quarter. Our adjusted EPS was $0.84 compared to $0.64 a year ago and $0.50 from two years ago. Lastly, our operating cash flow was up 21% to $141 million. Overall, I am pleased with our results.

Let me transition to strategy. As we look to complete FY14 and our first full quarter of GXS operations and results, I would also like to take a few minutes and provide an early preview into FY15 agenda. To begin with, we remain completely focused on establishing, strengthening, and delivering EIM.

Our direction is to build the world's largest enterprise B2B business network. We intend to achieve this by adding new services, more vertical applications, and growing our trading partners. B2B integration is a critical technology for the enterprise in EIM. We are focused on our EIM platform and the developer and our energy has now shifted from development to sales and customer adoption.

Further, we see the EIM applications market as pretty much wide open. EIM applications differ from ERP applications in such that they are information- and process-centric. Today we offer customers EIM applications focused in treasury management, transportation, logistics, invoice management, case management, contract management, and a few other areas. There are two very important enterprise information flows that weave our applications together, more than any other information flows. They are procure to pay and capture to archive.

Top of mind for FY15 is the cloud. We are now providing EIM, both on-premise and in the cloud. This offers our customers the flexibility to place workflows where they need to around the globe and in the data zone they find important to them. Continuing to scale our Cloud services is a key priority.

Consider our progress. Within ECM, we now offer our archive solution as both on-premise as a multi-tenant cloud service. Within BPM, our new Process Suite is fully multi-tenant and operates both on-premise and in the cloud. Within IX, our Fax, EDI, and B2B business network is a complete platform as a service.

Our suites are available through our managed service offerings, and as I have commented on earlier, we have 725 customers now running in that service where we manage and operate their infrastructure so they don't have to. The OpenText cloud is global, secure, and enterprise ready, and comes with data zones allowing companies to place their data in the country most relevant to their business needs.

Two years ago, our cloud-related revenues were effectively $0. In this quarter, Q3, we delivered $128 million, nearly equal to our license and professional services business combined and we have achieved this while growing margins and earnings.

Our on-premise business licenses is a perpetual business model; our cloud services business -- PaaS, SaaS, and Managed Services -- is basically a term business model. Let me be crystal clear: they are equally important to us. The extremes of everything will be in the cloud or everything will be on-premise is just wrong.

As an enterprise software and services Company, what our enterprise clients are telling us, is they want the flexibility in where they place their data and workloads. We see the world of on-premise and cloud both integrated and hybrid, and coexisting, and ultimately the same software running in any deployment model.

The full FY15 agenda and key metrics will be laid out on our next earnings call, but the summary of our FY15 strategy is centered on adoption of our EIM suites in the developer; delivering the world's largest B2B business network; the OpenText cloud; Managed Services; our PaaS services from GXS and Easylink; and new SaaS offerings like BPM-archived secured email with more services to follow; adoption of our EIM applications with more applications to follow; continuing with our proven business model of intelligent growth and value first; and effectively deploying $3 billion in capital for potential acquisitions in the coming years.

Let me provide some summary remarks and then we will it open up for Q&A. This was an important quarter for OpenText. GXS is now an integral part of our operations; our Q3 results were stellar; our intelligent growth strategy is working; we raised our dividend by 15%; the rise of cloud and the equal importance of cloud and on-premise and a profitable cloud; our EIM product line is up, strong, and our new EIM suites are delivering pipeline, new sales, and new customers; and I'm excited about what I see heading into Q4 and FY15. Operator, with that, we'd like to open the line for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions)

Kris Thompson, National Bank Financial.

Kris Thompson *- National Bank Financial - Analyst*

Mark, in your commentary you mentioned that you had about 300 customers looking at the upgrading to Content Suite 10.5 and normally every quarter you have 10 to 25 notable customer installations of $500,000 or more. That sounds very significant. Can you just give us an idea of if we should think about those customer upgrade potentials in the context of that type of size per customer?

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

Kris, thanks for the question. As we get here into Q4, this will really be our first full quarter of our EIM suites shipping. The Innovation Tour was real important, being able to educate, enable our partner network, as well as thousands of customers. Our deal sizes up to $307,000, which is an early indicator of some suite interest, and Content Suite was the first suite out after Enterprise World, so it's a healthy start to the upgrade cycle for the suite. It's a good early indicator.

Kris Thompson - ***National Bank Financial - Analyst***

Just really quickly, for Paul, Paul, there's been some headlines about the EU looking into some special tax structures over in Luxembourg. I'm sure you can't say much, but can you provide us any commentary, if you're concerned at all about your structure that you're about four years into? Thanks.

Paul McFeeters - ***OpenText Corporation - CFO***

No, actually, I'm not concerned about our structure, and back to the EU, they just today filed an action for annulment against their injunctions that they were having, so there's the EU matter. We don't believe that affects our structure. We're confident in our structure and so I have no concern beyond that.

Kris Thompson - ***National Bank Financial - Analyst***

Great to hear. Thank you, guys.

Operator

Thanos Moschopoulos, BMO Capital Markets.

Thanos Moschopoulos - ***BMO Capital Markets - Analyst***

Mark, can you expand a little further in terms of the issues that you called out in the America. Is that just a question of getting the right leadership in place or the right reps in place? How would you characterize the issues?

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

Thanos, thanks for the question. We operate in six, seven regions within the Americas and I would start a macro level. We run, globally, if you think of our sales force as a 10-cylinder engine, I'd say in the quarter we fired on nine out of 10. Of course, you want to fire on 10 out of 10.

Specifically, in the Americas, it's US West and Canada and I'd say -- and our opportunity and challenges are different in each. In Canada, it was leadership and we have a new leader in place and [Kana] is just fantastic. So we have Canada on the right track.

US West is a very unique market. It's Oracle-centric; it's a very tech-centric market, which isn't necessarily one of our biggest industries. Our EIM suite for Oracle out in the market, that's going to be helpful to us, and we had to get the right mixture of leadership, product mix, and synchronization with professional services and partners in the US West. So I think we're on the right track -- I'm confident were on the right track -- and I think we'll see those two regions, within two out of the seven Americas regions, get back to full contribution now that we've completed those changes.

Thanos Moschopoulos - ***BMO Capital Markets - Analyst***

Great and how would you characterize the overall spending environment heading into Q4? Would you say that it's stable or would you say that there's been signs of improvement, as evidenced by the growth in EMEA and APAC?

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

On the license side, EMEA grew greater than 10% in the quarter. APJ was closer to 20%, actually, but certainly -- albeit on a lower absolute base, so they both did well. I don't know what the technical economic term above cautious optimism is. There's probably some technical term, but I'm probably a notch above cautious optimism.

But persistent risks remain out there. You look at Crimea, Ukraine, certainly gave some folks pause, didn't affect us in the quarter. So I'm a notch above cautious optimism, whatever the technical economic term is for that, but still noting some persistent risks remain out there, but certainly all-in, an improving environment.

Thanos Moschopoulos - ***BMO Capital Markets - Analyst***

Great. Thanks, Mark. I'll pass the line.

Operator

Scott Penner, TD Newcrest.

Scott Penner - ***TD Newcrest - Analyst***

Just two questions. For you Mark, just wondering if you could give any update on AppWorks, any of the metrics that you're following and whether you've seen any developers come out with either test or production applications yet?

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

We are tracking subscriber growth right now and getting the, what I call, the high-value network on to the network, getting our system implementers on to the network, consolidating acquired networks on to the new application network. So our first push here is really getting the high-value network firmly planted and getting all of our suites into GA and out into the network. The real metric we're following right now is subscribers and getting the installed base turned on, and I'd say, we're probably north of 50,000 subscribers right now on the developer network, starting from zero in November to today, so a little greater than 50,000.

Scott Penner - ***TD Newcrest - Analyst***

Okay. Just a question for you, Paul, and that is the breakout of the deferred revenue and deferred implementation cost on the bottom-line impact of $1.9 million that you mentioned, is that an after-tax number or is that -- and is that included in the adjusted EPS?

Paul McFeeters - ***OpenText Corporation - CFO***

First, of all it's not an after-tax number. And as you know, Scott, it's actually not in the numbers, we were indicating that because of the acquisition, we had to do fair value accounting or another way we just describe it a write-down of what was on their balance sheet and the impact of that would have, went otherwise, if hadn't been written down, on we will call it, the revenues and the cost of sales and expenses. So you said it right in your note today after our release, is that you might [notionally] add that back in through what the revenue would have been, except for the purchase price accounting adjustments. The impact of that on future quarters is now in a chart in our IR deck on our website.

Scott Penner - ***TD Newcrest - Analyst***

Right. Okay. Appreciate it. Thanks.

Operator

Blair Abernethy, Cantor Fitzgerald.

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

Just two questions on the cloud side. Paul, you mentioned the GXS contribution to cloud maintenance and license. You left out pro serv. Was there any GXS revenue pro serv?

Paul McFeeters - ***OpenText Corporation - CFO***

No there's nothing group there in the professional services

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

Okay, great. And then just in terms of the Easylink business, it looks like it was down 5%-ish sequential, maybe 10% year-over-year. Can you just tell us how that's -- what's going on there in that business?

Mark Barrenechea *- OpenText Corporation - President and CEO*

Blair, hi, it's Mark. It's mainly our broadcast business in Japan and Asia-Pacific. It is a low-value, low-margin business on commodity broadcast fax that we think will continue to trail down through time and replaced with higher-value services. But it's basically us winding down the broadcast fax business in Asia-Pacific.

Blair Abernethy *- Cantor Fitzgerald Canada - Analyst*

Okay, great. Thanks very much.

Operator

Richard Tse, Cormark Securities.

Richard Tse *- Cormark Securities - Analyst*

With respect to Red Oxygen, are you expecting a bit of an acceleration now in license growth, given that the entire portfolio is going to be out of the market here within the month?

Mark Barrenechea *- OpenText Corporation - President and CEO*

Richard, thank you for the question. We've been focused on getting the products into full general availability, driving into the installed base awareness education, getting professional services and our partners enabled. This will be our first full quarter, I'd say, of having the suites available and at least rounding the bases once on education and enable [then].

I'm not going to speak to a license growth rate -- a future license growth rate -- but there is interest and we're building a pipeline and the first take of Red Oxygen is favorable. We also saw, and I'll highlight again, our -- within the quarter EMEA license growth, a little higher than 10%, at APAC, greater than 10%, closer to 20%. A couple of challenges for us that were more execution-oriented in the Americas, but we [have] back on track to fix over the next one to two quarters. So I'm optimistic on the first take that Red Oxygen is positive.

Richard Tse *- Cormark Securities - Analyst*

Okay and then could you elaborate in any way on -- you guys seem to be getting a little bit more aggressive on your IP and maybe give us a bit of color into why that's been the case?

Mark Barrenechea *- OpenText Corporation - President and CEO*

Sure. We have a little over 500 patents and we have sued Box and Alfresco. We've sued them for infringement and we will absolutely defend our intellectual property with there are companies knowingly and blatantly infringing on our intellectual property, which we believe those two companies have done. So look, we don't -- let me leave it at that (laughter). All right. We have a little over 500 patents, we have filed 200 claims, basically in roughly 12 patents, but to we will defend our IT when folks knowingly and blatantly infringe against our intellectual property.

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

Okay and one last question here. You've had GXS on your belt for a little while now. What do you think needs to be done, the main things that really drive the revenue synergies here going forward?

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

There's more value to unlock -- off to a fast start, more value to unlock. This is our first full quarter of operations; last quarter was a partial quarter; this is a full quarter. We still have our back office synergies to complete, as Paul highlighted. We have data center consolidation, network consolidation yet to complete.

And we have cross-pollination of product portfolios, where GXS focused on B2B integration, can take advantage of our invoicing applications and where the Easylink and broader ECM installed base can take advantage of a stronger B2B network. So it's really about existing cross-product education of the enterprise sales force and GXS and Easylink sales forces and we'll have that fully complete as we kick off FY15 and that will be a big driver for us in FY15.

Them beyond that, is adding more applications on top of the network. So there are a series of waves here, if you will, from a full quarter, to back office synergies, to network data center consolidation, cross-sell opportunities, joint customers, and then a fuller portfolio that will continuously unlock the value over the next one to five quarters.

Operator

Stephanie Price, CIBC World Markets.

Stephanie Price - ***CIBC World Markets - Analyst***

Now that Red Oxygen is rolled out, can you talk a bit about the time line to Blue Cobalt (sic -- see comment below, "Blue Carbon") and how you see the solution evolving over time?

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

We give our releases project names, so Project Red Oxygen, which is now behind us, and we are using the product name, so our EIM suite. And really our attention and the customer attention is driving awareness, education, and adoption. Our next release is code named Blue Carbon and it's a release that will focus more on cloud, applications, and analytics.

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Those are the three big drivers we've highlighted for Blue Carbon -- applications, cloud, and analytics. And hey, look, we're going to unveil more but come November in Enterprise World. But the main energy right now is focused on education, enable, adoption, pipeline, upgrades, new clients on Red Oxygen. The drivers, again, behind Blue Carbon -- apps, analytics, and cloud -- more cloud and that will be unveiled, more specifically, in Enterprise World in November.

Stephanie Price - ***CIBC World Markets - Analyst***

Okay, great. And in terms of the transactions, you recorded over $1 million. Can you talk a bit about them in general terms -- the theme with customers -- what customers were buying and what sectors were most active and if any of the deals were Red Oxygen-related?

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

Sure, so we did six license transactions over $1 million and I would -- we did six license transactions over $1 million -- I would say one-half of them were related to Project Red Oxygen. We did nine transactions, nine bookings over $1 million in the cloud, which is a different product line and not related to our new EIM suites. About 25% of our business was from new customers and our average transaction size was up in the quarter to $307,000.

Stephanie Price - ***CIBC World Markets - Analyst***

Right. And then just finally, in terms of Q4, Paul, can you just confirm that you're expecting the typical license seasonality for the quarter?

Paul McFeeters - ***OpenText Corporation - CFO***

I can't, but thanks for asking me. As you know, we just really have stopped discussing seasonality ranges now well over a year, so I really can't comment on it.

Stephanie Price - ***CIBC World Markets - Analyst***

All right. Fair enough. Thank you, gentlemen.

Operator

Paul Steep, Scotia Capital

Paul Steep - ***Scotia Capital - Analyst***

Mark, maybe you could talk a little bit on the cloud side about Managed Services and the level of investment there. I know when you bought GXS, I believe it was about 39%, 40% of revenue there? And then secondly,

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just following up on the comments last quarter about a slight displacement in cloud revenue in the first bit; do you feel we're through that or if we've got potentially some in Q4 as well?

Mark Barrenechea *- OpenText Corporation - President and CEO*

One of our strategic rationales for acquiring GXS was their Managed Services business. We liked it in of itself for the B2B network, but we also saw a path to integrating, consolidating with the OpenText infrastructure, and being able to move our EIM suites into that information infrastructure and we are laser-focused on that. We've begun to see the first results of that, of bringing on board about 25 new clients within Q3 -- so 25 new clients came into the Managed Services environment within the quarter, so 725 distinct businesses now run in Managed Services.

We're laser-focused on growing and getting more customer environments to migrate into the -- what we will commonly called the OpenText cloud. We're also very knowledgeable and very skilled at, what I would call, data zones, being able to place data in the right country. So if we're running a client in Switzerland or Germany or France or Canada or Japan, we can place workloads and data commensurate to their business requirements.

We don't see a lot of -- your second question, we don't see a lot of all cannibalization across our product portfolios, because we don't have overlapping cloud versus on-premise solutions, so we have some overlap in the fax business. We had historically, RightFax and then the PaaS for Easylink, but clients at this point have made their decisions where they want to place those workloads. So there may be some slight up and down in any given quarter, but this isn't a mass migration for that part of the business. Clients have made their decisions for the most part where they want to place their workloads.

Paul Steep *- Scotia Capital - Analyst*

Great, and just a quick clarification for Paul, because I know he likes forward-looking statements here (laughter) -- on the software capitalization side, Paul, thinking out a couple of years, as you continue to invest in the OpenText grid and cloud, how should we think -- I know that snuck into the [Q] tonight -- how should we think about capitalization of software hitting the balance sheet or still very tiny number in terms of overall R&D spend?

Paul McFeeters *- OpenText Corporation - CFO*

The timeline of our development in our release puts it within more of a currents period as opposed to the rules where we'd have to capitalize and amortize that over time. It's not an absolute statement, Paul. There are situational conditions where, of course, we are required to capitalize; that's happened, as you probably know, more so in GXS.

Again, our development cycle here has been upgrades, and as I said, the development cycle and the [delivery] cycle is a fairly short one, which I don't see for OpenText, that really changing significantly. I will continue, of course, to manage that process in the GXS business.

Paul Steep *- Scotia Capital - Analyst*

Perfect. Thanks, guys.

Operator

Paul Treiber, RBC Capital Markets.

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

Paul, you mentioned in the prepared remarks that the increase in cloud services margins was due to a reduction in telecom costs. Could you elaborate on that? And then also the margins were slightly above the target model you have, so are they sustainable where they are or do you see them dropping back?

Paul McFeeters - ***OpenText Corporation - CFO***

I'm going to say with the operating margin, to answer that question first, look, we've already -- the team did a great job in starting to rationalize the size of the business, combined businesses. It was one of the contributing factors, it wasn't the single contributing factor, but again it speaks to really how size and negotiation ability improves with size and that was one of the early wins and we think there is more across, as Mark mentioned, there's more opportunities on cost savings, naturally, to get the Company under the operating model that we spoke of in the timeline that we spoke of. But at this point, I'm not prepared to adjust the target operating model, but we will address it more formally in Q4 as we look at FY15.

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

Okay and then a similar type of question as regards to depreciation. It just looks like this quarter, it was slightly below the target. Again, could you just elaborate on that?

Paul McFeeters - ***OpenText Corporation - CFO***

Similar answer, Paul, that we would be -- you could look into Q4 in about the same range, but it's somewhat connected to the previous question we got it with respect to how we look at internal capitalized projects and the depreciation on that. So we're evaluating how that will look in both OpenText, of course, and GXS.

That affects, of course, the depreciation charge, but what you saw in Q3, they will probably similar for Q4 -- again, and I'll be in a better position at the end of Q4, when we pronounce results and talk about our FY15 model, what's that depreciation range. It won't change the model today. I'm not suggest I'm going to change it then, but I'll stay with that range.

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

Okay. And Mark, just in regards to your comments on on-premise and cloud coexisting, how should we think about the underlying growth of those types of markets? Should they grow in line with each other or do you see one growing faster than the other?

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

Paul, good question. We haven't put out market studies yet on the cloud side. We know what the on-premise market rates are for the license side. That deserves a little more study and maybe part of -- when we get to next quarter and talk about FY15 a bit more specifically in metrics.

Clearly, the cloud is growing. We expect it to grow, but to put more of a frame around it, with EIM, let's defer that maybe to next quarter in context of FY15 year? We obviously expected to grow. Managed Services, we are expecting to grow, it's a focus for the entire Organization. But let me give that some more thought, put it in context to 2015, just as we've given great thought to the license side of EIM, so we'll come back to you on that.

Paul Treiber *- RBC Capital Markets - Analyst*

Okay. Sounds good. I'll pass the line.

Operator

Eyal Ofir, Clarus Securities.

Eyal Ofir *- Clarus Securities - Analyst*

First off, just on the average selling price, it's a nice uptick here, by the way, so congratulations on that, the $307,000. My question is, is that a function of seeing more enterprise-wide deployments and bidding more enterprise-wide? Is it also a function of Red Oxygen or maybe a little bit of both?

Mark Barrenechea *- OpenText Corporation - President and CEO*

Eyal, I'd say it's more directly to EIM suites, not enterprise, not ELAs but rather more -- it's not unlimited, it's more suites.

Eyal Ofir *- Clarus Securities - Analyst*

Okay, so then now, heading into the June quarter here, more of these suites are available. Obviously, you have a pretty healthy pipeline. So we can anticipate this metric to continue to increase?

Mark Barrenechea *- OpenText Corporation - President and CEO*

We're not going to comment on those future metrics

Eyal Ofir *- Clarus Securities - Analyst*

Okay.

Mark Barrenechea *- OpenText Corporation - President and CEO*

But what we have said, right, is that we do expect the number to be related to more suite sales, but we're not going to get into what we expect the number to be.

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

Okay. I appreciate that. Congrats on that. One follow-up question is to some of the other comments you've made. So number one, just on the fax business in Japan and APAC, you're saying there is still more declines. Can you -- any way to size that up? Then number two, on your patent litigation against Box, would there be other players in that space that could be potentially infringing, as well, and I'll leave it there?

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

Range-wise, on the fax business, we'll work through it over the next two to four quarters and I'd size the broadcast fax business today between $5 million and $15 million. All right?

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

Okay.

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

Look, we're focused right now on two companies, Box and Alfresco, and I won't comment more broadly as to -- on any other targets. Again, if we -- we take this, obviously, quite seriously and if we find someone who is knowingly and blatantly infringing, we will protect our IP.

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

Okay. Thanks. I'll pass the line.

Operator

Michael Anderson, Credit Suisse.

Michael Anderson - ***Credit Suisse - Analyst***

It looks like you guys had a very nice rebound in the public sector this quarter, where [a la] contributed about 20% of license. Can you just comment on the regions or suites that helped generate that strength and what that pipeline looks going into next quarter?

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

Mike, thanks for the question. I won't get into the pipeline part, but I'd say it's primarily our Content Suite and our Process Suite. So we had a nice win and I look forward to the go-live and then the value of that Malaysian government will gain from putting in information records, platform in.

We're doing another large deployment in Hong Kong, the Home Office for records and mail room management in the UK, and a couple of other Eastern European wins, as well. So it's really around core platform content management, digitalization, process management, which cuts across the Process Suite and the Content Suite.

Michael Anderson *- Credit Suisse - Analyst*

Got it. And then switching gears slightly, your new license from new accounts, it was 25%, maybe a tick down from where it has been normally over the last few quarters. Can you comment on just the competitive environment, in general, how that's been playing out and how maybe Red Oxygen is changing the discussion or changing the buying patterns of your current and/or new customers that you're trying to acquire?

Mark Barrenechea *- OpenText Corporation - President and CEO*

Two questions in there. I'll -- maybe the first part, 25% from new customers. We've been very focused on the installed base and it's the first place we're going with our new suites in the market, so it doesn't surprise me to see the number trail down a bit because we're going first to our installed base. So it's where the number probably should be, given the installed base focus.

On the competitive side, I'll go market-by-market. We're feeling more confident in the content management space. The drivers there are more integration, being able to have a development platform. We see FileNet as our top competitor in that space.

There are more vendors there, of course, but FileNet as our top competitor and we're innovating, more and more than FileNet. We're embracing the developer, a broader EIM vision, integration to SAP, now Oracle work, so we think we're in a very good competitive position on the Content Suite.

On the Process Suite, we think we have something pretty unique to be able to offer multi-tenant process app in the cloud. The 10.5 release of Process Suite, fully multi-tenant, in the cloud, this is a combination of Cordys, Global 360, and Metastorm, all brought together in a multi-tenant offering in the cloud. So we think we have something quite special there.

In the Experience Suite, we've gone through a front-end rewrite to be able to offer JavaScript, HTML5, a CSS architecture, to delivered an omni-channel experience, where we'd be going head to head against the Adobe marketing and digital suite.

And then on the IX side, with Easylink and GXS combined, we're just a bright-line market leader over Sterling Commerce Liaison and other players there. So we're feeling more confident on the competitive side, suite by suite, and as we get closer to Blue Carbon, but I don't want to get distracted on Blue Carbon, we need to win suite by suite, we need win secular competitor by secular competitor, and then create our competitive barriers across the entire offering through more integration. So FileNet, Adobe, and IBM Sterling Commerce Pega are our top competitors and Red Oxygen puts us that much further along in winning.

Michael Anderson *- Credit Suisse - Analyst*

That's very helpful color. Really quick one for Paul, can you just comment on how renewal rates have been, and as you go back to your installed base and essentially upsell them, do you expect that they could actually trend up slightly over the next four to six quarters?

Paul McFeeters - *OpenText Corporation - CFO*

Well, first of all, our rates are staying stable in the low 90%s and we do have people in that group that are doing some, we'll call it, upsell and projects, though, look I can't comment. We won't give that guidance in terms of the next four quarters, other than to say, we are very confident at the existing renewal rate. Perhaps we will say, we're very confident that we don't see really any erosion in that.

Michael Anderson - *Credit Suisse - Analyst*

Great. Thank you very much, guys.

Operator

Ralph Garcea, Global Maxfin Capital.

Ralph Garcea - *Global Maxfin Capital - Analyst*

Just two quick ones here. In the large deal environment, Mark, is there any different in the sales cycles between a cloud sale and an EIM sale, is the first question? And are you are Jon doing anything different to avoid back-end-loaded quarters with regards to these larger deals?

Mark Barrenechea - *OpenText Corporation - President and CEO*

Well, in terms of back-end-loaded quarters, it's still technology (laughter). So it's just the nature of the industry, that folks wait to late, late, late in the quarter, and you've got to stand on value and differentiation, which we do. First observations, here with the GXS business is that the sales cycles are commensurate with core EIM suites sales cycles. These are usually two- to three-quarter sales cycles, at the $1 million enterprise level. We did six license transactions greater than $1 million, nine cloud bookings greater $1 million, and they feel of equal complexity, value, and length.

Ralph Garcea - *Global Maxfin Capital - Analyst*

And then just on the one cylinder that's not working with regards to Canada and the US West, was it sector-related -- public sector versus commercial -- or was it just personnel issues and they've been rectified and move on?

Mark Barrenechea - *OpenText Corporation - President and CEO*

We believe we've made the corrections and we've moved on and we'll be back on track here in one to two quarters. Different challenges, different opportunities. In Canada it was leadership, and the Canadian market here at home is a unique market. West, central, east, provincial markets, as well as federal markets; provincial markets also have healthcare and utilities and obviously government. So getting that right expertise who understands the market, understands the segmentation, understands the accounts, how to bring right partners in from Microsoft, SAP, and others and create that environment, it was leadership. We fixed it and we'll be back here on track.

In the West, US West has always been an interesting market for OpenText. It's a very technical market -- one driven a bit more by Microsoft and Oracle, quite candidly and getting our portfolio mix, our professional services mix, and the leadership to focus the Organization, we've -- we now better understand the market and what we needed and we've put that in place and I think it will get back on track here in one to two quarters. So I use the analogy of a 10-cylinder engine; we fired nicely on nine out of 10 cylinders and getting that next 10th cylinder to fire will be that much more additive.

Ralph Garcea *- Global Maxfin Capital - Analyst*

Okay. Perfect. Thank you.

Operator

Ladies and gentlemen, that is all the time we have for the Q&A today. I will now turn the call over to Mr. Barrenechea for any additional comments or closing remarks.

Mark Barrenechea *- OpenText Corporation - President and CEO*

All right. Thank you. Thank you for the time and thank you for the questions today. I look forward to seeing -- Paul and I look forward to seeing many of you on our investor road shows in the coming weeks. This ends today's call.

Operator

Ladies and gentlemen, this concludes the conference call for today. Thank you for participating. You may now disconnect your lines.

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