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# EDITED TRANSCRIPT

OTC.TO - Q3 2015 OpenText Corp Earnings Call

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**OVERVIEW:**

Co. reported total revenue of \$447.6m, GAAP net income attributable to Co. of \$26.6m or \$0.22 per diluted share.



## CORPORATE PARTICIPANTS

**Greg Secord** *OpenText Corporation - VP of IR*

**John Doolittle** *OpenText Corporation - CFO*

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

## CONFERENCE CALL PARTICIPANTS

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

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

**Philip Huang** *Barclays Capital - Analyst*

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

**Eyal Ofir** *Dundee Capital Markets - Analyst*

## PRESENTATION

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### Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation third quarter 2015 financial results conference call.

(Operator Instructions)

The conference is being recorded.

(Operator instructions)

At this time, I would like to turn the conference over to Greg Secord, Vice President, Investor Relations. Please go ahead.

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### **Greg Secord - OpenText Corporation - VP of IR**

Thank you, operator, and good afternoon, everybody. I would like to start the call with a reading of our Safe Harbor statement. Please note that during the course of this conference call, we may make statements relating to the future performance of OpenText that contain forward-looking information. While these forward looking statements represent our current judgment, actual results could differ materially from a conclusion, forecast, or projection in the forward-looking statements made today. Certain material factors and assumptions were applied in drawing any such conclusion, while making a forecast or projection as reflected in the forward-looking information.

Additional information about the material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information, and the material factors or assumptions



that were applied in drawing a conclusion while making a 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 Forms 10-K and 10-Q, as well as in our press release that was distributed earlier this afternoon, each of which may be found on our website. We undertake no obligation to update these forward-looking statements unless required to do so by law.

In addition, our conference call will include discussions 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. And with that, I would like to welcome everybody to the call.

With me today is OpenText President and CEO, Mark J. Barrenechea, as well as our Chief Financial Officer, John Doolittle. As with 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've posted an updated PowerPoint that will be referred to during this call, as well as a summary table highlighting OpenText's historical trends and financial metrics.

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

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**John Doolittle - OpenText Corporation - CFO**

Greg, thank you very much. First of all, I want to welcome everyone to the call. And second of all, I am very pleased, Greg and I are very pleased to be sitting here in person with Mark in our Silicon Valley Actuate office. Mark, it's great to see you, and look forward to your comments, shortly.

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

Yes, looking forward to it. Thanks, John.

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**John Doolittle - OpenText Corporation - CFO**

Yes, so turning to the financial results for third quarter of FY15, as noted in my quote in the press release, foreign exchange had a very significant impact on our top line, bottom line, and our comparatives for the quarter. Compared to Q3 2014, revenues were negatively impacted by \$30.9 million, and adjusted EPS negatively impacted by \$0.07. Total revenue for the quarter was \$447.6 million, up 1% compared to \$442.8 million for the same period last year, and on a constant currency basis using rates in effect during Q3 2014, total revenue was \$478.5 million, up 8.1%.

Regionally, the Americas contributed 58%, EMEA 33%, and Asia Pacific 9%. Recurring revenue for the quarter was \$383.6 million, up 4% year-over-year, compared to \$369.7 million for the same period last year. On a constant currency basis, recurring revenue was \$408.2 million, up 10%.

I would like to now take a closer look at components of recurring revenue. First cloud services revenue for the quarter was \$143.8 million, up 12% from \$128.4 million in the same period last year, and up 17% on a constant currency basis. The increase is primarily from the GXS stub period, which had revenues in North America and EMEA. Cloud services gross margins decreased to approximately 58% in the quarter, from 62% in the same period last year. Margins were impacted by bad debt expense, the timing of certain other expenses, and the nonoccurrence of certain one-time credits that will not repeat.



Customer support revenue for the quarter was \$184.3 million, up 2% compared to \$180.3 million in the same period last year, and up 10% on a constant currency basis. Customer support gross margins remained relatively stable at approximately 87%, compared to the same period last year. Professional services and other revenue for the quarter was \$55.5 million, down 9% compared to \$61 million in the same period last year, however, only down 2% on a constant currency basis.

Professional services gross margins, 20% in the quarter versus 19% in the same period last year. The improved margins were primarily due to lower labor-related expenses, associated with lower revenue attainment, and a reduction in the use of our subcontractors. Margins are off since last quarter, primarily on account of Actuate, which had historically low services margins, nonrecurring impact of one-time charges, and some timing differences on expenses.

In terms of license revenue for the quarter was \$64 million, it was down 12%, compared to \$73.1 million reported for the same period last year, down 4% on a constant currency basis. The decrease in license revenue was primarily due to the EMEA, where we continue to see selling challenges in an overall tough economic environment. Gross margin for the quarter, before amortization of acquired technology and stock compensation, 70.8% compared to 71.3% in the same period last year. The year-over-year gross margin slightly lower, primarily because of revenue mix and margin variances.

Pre-tax adjusted operating income before interest expense and stock compensation was \$115.2 million this quarter, down 11% compared to \$129 million in Q3 of last fiscal year. And on a constant currency basis, adjusted operating income, \$125.9 million, down 2% compared to Q3 of last fiscal year. Adjusted net income decreased by 21% to \$[80.6] million in this quarter, down from \$102.6 million in Q3 of last fiscal year. On a constant currency basis, adjusted net income decreased by 13% to \$88.9 million. Adjusted earnings per share, \$0.66 on a diluted basis, compared to \$0.84 for the same period last year, down 21%. On a constant currency basis, adjusted earnings per share was \$0.73, on a diluted basis down 13%.

Overall adjusted earnings per share was negatively impacted, primarily by foreign exchange fluctuations, the additional interest expense, our lower license revenue, and the 4 point percentage increase in our adjusted tax rate from 14% to 18%. During the quarter, we closed the acquisition of Actuate and IGC for approximately \$332 million and \$40 million, respectively. And in the quarter, Actuate contributed \$14.5 million of revenue, after a reduction for purchase price adjustment of approximately \$3 million.

Actuate's adjusted operating margin would have been approximately breakeven, but for this purchase price adjustment to revenue. The adjusted tax rate for the quarter was 18%, an increase of 4% from the same period last year. On a GAAP basis, income from operations before interest and taxes for the third quarter was \$52.6 million, down 21% from \$66.8 million in the third quarter of last year.

GAAP income before taxes, \$26.2 million in the current quarter versus \$58.8 million in the same period last year. The decrease in income is primarily due to higher interest expense on account of our high yield bond issue, foreign exchange losses, and amortization expense from new acquisitions. Net income attributable to OpenText for the third quarter in accordance with GAAP was \$26.6 million, or \$0.22 a share on a diluted basis, compared to \$45.8 million, or \$0.38 a share on a diluted basis the same period last year.

The Company achieved its highest-ever operating cash flow, and we are very pleased about that, at \$143.1 million, an increase of 1%, compared to \$141.4 million in the period last year. We're pleased with our strong working capital management in the quarter. There were approximately 123.1 million shares outstanding on a fully diluted basis for the third quarter of 2015.

Moving to the balance sheet, deferred revenues were \$384.8 million, compared to \$349.9 million at June 30, and \$352 million at March 31. A big change this quarter was the contribution of Actuate, of \$35 million attributable to deferred revenue in the quarter.



Accounts receivable was \$251.8 million, compared to \$292 million at June 30, 2014, and \$257.3 million at March 31. Day sales were 51, compared to 53 and 52 in the previous periods. At March 31, our headcount was approximately 8,700, 2,200 in R&D, 2,100 in cloud, 800 in customer support, 1,000 in professional services, 1,500 in sales and marketing, and 1,100 in G&A. If you back out the acquisitions of Actuate and IGC, headcount was 8,200, and was relatively flat, compared to a headcount of 8,100 in March of last year.

Part of our commitment to bring value to our shareholders, on April 27, the Board declared a cash dividend of \$0.20 per share for shareholders of record on May 29, 2015, payable on June 19, 2015. This is an increase of 16% from the last declared cash dividend of \$0.1725 per share. The target model that we issued at the beginning of the year remains unchanged, and we will provide the usual update for next fiscal on our next call.

And last thing I'd like to do, is just point to slide 9 in the investor deck that was sent out, and I just wanted to make sure that everyone on the call was aware of these key financial metrics. You can see that we've broken this down into three buckets. The first is foreign exchange. I've covered that pretty clearly, but just points out 33% of our revenue is from Europe. Here is the impact in the quarter and year-to-date from foreign-exchange.

And then, we've also line by line given you our 12-months trailing growth rates for each of our revenue line items. And lastly, just to confirm the tax rate for the remainder of this fiscal year remains at 18%. Obviously, we will update next year, when we update you on the next call. And interest expense is expected to remain at approximately \$18 million per quarter.

So that's the end of my presentation. Very pleased to be turning the call over to Mark.

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

Thank you, John, and welcome everyone, to our FY15 Q3 earnings call. The global economy, and our industry are experiencing a fair amount of change, and in that change we see great opportunity for OpenText. The strengthening of the US dollar, lowering GDP growth rates, energy prices, and political conflicts are top of mind when we look at the global landscape today. It is not an easy selling environment in many countries.

Further our technology industry has transitioned to what I call the subscription economy. Customers want more choice and flexibility on how they consume technology. What has not changed in our view, is that great companies who return long-term value to their shareholders, focus on capital allocation, profitability, earnings and cash flows. I [put OpenText] firmly in this category.

Let me start with foreign exchange and the strengthening of the US dollar. And as a reminder, we are a Canadian company whose reporting currency is the US dollar. Over the last 12 to 14 months, the euro has moved against the US dollar from \$1.37 to \$1.10. The Canadian dollar has moved from CAD1.05 to \$0.80, US, approximately. Within Q3, the euro alone moved 7% against the US dollar. With that in mind, I would like to draw your attention to our press release, and ensure you see our constant currency tables, and their effects within the quarter.

In Q3 alone, FX had a \$30 million negative impact on revenue, and a negative impact of \$0.07 on adjusted earnings. Year-to-date revenue has been negatively affected \$42 million, and adjusted earnings negatively affected \$0.09. It goes without saying, our business performance is subject to foreign exchange. These are very unique moments in foreign exchange, and what are we doing about it, and what's in our control?

Well, we will continue to manage to the bottom line in strong cash flows. Within Q3, we had record operating cash flow of \$143 million. Over the last two years, we returned \$156 million to shareholders via our quarterly dividend program, which is now entering its third year. With our dividend target being 20% of trailing 12-month operating cash flows, and the consistent strength in our operating cash flows, we are again raising our quarterly dividend, as John mentioned, now to \$0.20 a share.



We continue to look at hedging various expenses, as we look to extend our existing investment in labor resources at our Philippines, Indian and Canadian facilities, where and when we add new employees. At the end of the day, we may continue to have revenue volatility due to foreign exchange. We believe we can add value to shareholders, by continuing to carefully manage our bottom line, generating solid cash flows, and of course, our dividend program.

Let me transition a bit to the cloud. We have entered what I would like to call the subscription of economy, where consumers and enterprise customers alike want more choice. And by choice, we mean the ability to subscribe to a service, whether that service be on-premise, hosted in the OpenText cloud, or hosted in somebody else's cloud, or the ability to gain access to OpenText capabilities via a SaaS model or web-based services.

Across the industry, we see the largest technology firms such as IBM, Oracle, SAP and Microsoft leading with the message of cloud. At OpenText, we continue to see our business solutions as hybrid, delivering for our customers both on-premise and in the cloud. And presently, there is a strong interest in these cloud-based solutions and cloud-based economics, a/k/a subscription pricing. Over the last couple of years, we have gone from near zero in cloud services revenues to \$143 million in this quarter. We run our cloud services at industry-leading margins, and are bright line profitable. As the majority of you know, the majority of cloud businesses out there in the industry today are not profitable, and that is not sustainable for those companies long-term.

We, by contrast, have built our cloud business on a business model, that we can scale via our own innovation and acquisitions, and have chosen profits over hypergrowth. In November 2014, at Enterprise World, we introduced a full range of cloud service options, that would go operational in January of 2015. These options are now available to customers, which include a three-year subscription to our software, new managed services for the enterprise business, new SaaS offerings like OpenText core, and other options as well.

We have been delivering cloud services for a couple of years now, supported by strong and expanding recurring revenues, up 10% in constant currency this quarter, and a total of recurring revenues at 86% within the quarter. We've also growing our adjusted margin over this multi-year period, as well as grown our cash flows. In our first 90 days with these new options, we have seen solid interest from our enterprise and iX customers. To be crystal-clear, we are agnostic to whether a customer purchases a license, or a subscription or managed services from OpenText. Rather, we are focused on winning the customer and cashing the lifetime value of that relationship.

As we have said in the past, we expect and planned for this expansion of customer choice. In many ways, a subscription after three years can be more economically beneficial to OpenText, than a license. We will continue to manage to key metrics. They include recurring revenues, adjusted net income, and cash flows. At the end of the day, we will continue to invest in world-class products for our customers, in whatever way they wish to consume them.

John has covered the quarter well, and let me add a few additional in-quarter remarks, and then I'll speak about customers, and our direction over the next 12 months. We did not meet our financial objectives for the quarter, and let me summarize this. Our revenue was affected by FX, and new customers considering our cloud solutions. Our cloud services business was up, our maintenance business was up, our license business was down.

(Technical difficulty) focused more on margin contribution, versus optimizing revenue, and when we deliver margins in the low 20%, we are pleased. Our profit was affected by FX and some unique items in the quarter, such as acquisition costs, PPA expense, bad-debt expense and litigation expense to name a few. Our cash flows were a record high. As I mentioned early in the script, it does remain a tough selling environment in many countries as well.



Let me spend a little bit of time on customers, and I would like to add some highlights, as well as spend time on our direction. We had a good quarter for enterprise customers selecting OpenText. New [IX bases] included Manulife, Hasbro, Coors and Roche Diagnostics.

New ECM, ECM business included the State of Maine, which also included our new Brava solutions from IGC, T-Mobile for customer portals, Central Hudson for engineering documents, and the ECB as new regulations are instituted across the European banking system. New BPM business included [Pillar] who bought our client management solutions, Optuminsight who expanded their Process Suite platform, and Trustmark who purchased Execute 360. Analytics included Hartford Insurance for [print streaming], Bank of Nova Scotia using our technology in customer-facing applications, and Fujitsu for reporting from their cloud. We're focused on leading and winning the digital transformation for enterprise customers, and as you can see from the quarter customer wins, we are winning key enterprise accounts.

Within the quarter, we closed on our Actuate acquisition, and entered the analytics market with two leading industry products in BIRT iHub, for operations reporting and dashboarding, and BIRT analytics for forecasting and predictive analytics. This is an exciting opportunity for our customers and partners.

We see opportunity in standalone analytics, embedded analytics, as well as providing content-rich integrations into our EIM offerings. Within the quarter, we delivered integrations into ECM for reporting big data analysis, as well as an iX offering to analyze trading [grade] data. We also completed many of the backoffice integrations within the quarter, and expect Actuate to be fully integrated, and on our operating model within 12 months of the acquisition date.

Within the quarter, we also delivered SP1. One key capability in SP1 is process center for SAP, integrated into our Content Suite for extended ECM products, giving users end-to-end visibility to their SAP processes, sales orders, invoices, delivery notes, and many others. These applications include new highly technical machine learning capabilities to capture and memorize both formats and metadata, making it easier for SAP customers to find data rapidly.

We also delivered a new media management solution with a robust creative review module. We have already seen several of our large media customers migrating to this solution, like Target and 20th Century Fox. Further, we delivered a new contract management module built on top of Process Suite, that supports both the buy and sell side contract lifecycle, and this, of course, is fully integrated with Content Suite

Next for us is Blue Carbon, which will focus on several new areas. Blue Carbon is an important release for us, as this will be our third year focused on EIM, an integrated suites of software to deliver a digital enterprise. We expect to have initial deliveries of Blue Carbon at the end of this calendar year, but in the meantime, our sales force and customers remain focused on the robust SP1 suite of products.

Our top focus in Blue Carbon is on completing key information flows, capture to disposition, create to publish, procure to pay, incident to resolution. It took ERP 20 years to deliver complete information flows for backoffice automation, and our process is comprehensive enough, touches enough employees or customers, and when you can fully automate it end-to-end with one piece of software for one supplier, with little to no integration of services, you create a catalyst for your software. This is our objective with Blue Carbon, and three years of focused commitment and investment with EIM.

We will also include a new release of [Content server] with a new user experience later -- layer, for the modern knowledge worker, and also new releases of StreamServe, InfoFusion, and Auto-Classification. Also a new release of our Process Suite, which will enhance the application development process, and more integration into smart workflows. A business analyst will truly be able to develop applications to extend the Process Suite without any programming required. Over the next 12 months, we will lead with cloud, analytics, SP1, and complete suites of software with Blue Carbon. Of course, these key innovations are not yet fully reflected in our financial results.



Let me also provide a brief update on myself. In February, the Company announced I was to undergo leukemia treatment over the next 100 days. We remain on that plan, and I am making good progress. And while I have cut back on my travel, I remain fully engaged in the day-to-day strategy and decision-making of the Company.

Let me thank everyone for their well wishes. Your support has been warming, and inspiring, and at times very creative. I can't thank you enough for the support.

Let me move to conclude my prepared remarks. The headlines for me in Q3 are foreign exchange, cloud, some unique expense items, strong cash flows, and a strong product line-up. The US dollar strengthened so dramatically, it clearly had effect on our top and bottom lines, but we were able to deliver solid cash flows and a 16% increase in our dividend program.

We also had unique expense items that we do not see as recurring, and we see an opportunity to manage expenses and people, as foreign exchange volatility presents itself. As John stated, we have reaffirmed our FY15 target model, which remains unchanged. Over the last two years, we have delivered a solid cloud services business, which continues to gain more interest with customers. We've recently launched new subscription SaaS and managed service options in January, and early indications, positive.

We are also entering a new business area for the Company, analytics. We are not yet even 90 days into this. Our product and services line-up strengthened in Q3 with cloud analytics and SP1, and Blue Carbon is scheduled for the end of the calendar year, will represent three years of commitment and investment to delivering an integrated suite of software for EIM, and enabling customers to deliver a digital enterprise.

Again, OpenText is committing to leading and winning the digital enterprise with EIM for our customers, through our own innovations and through acquisitions. With that, I would like to turn the call over to the operator for your questions.

## QUESTION AND ANSWER

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### Operator

(Operator Instructions)

Richard Tse, Cormark Securities.

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### Richard Tse - Cormark Securities - Analyst

Yes, thank you, Mark. Really good to hear that you're doing well here.

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### Mark Barrenechea - OpenText Corporation - President & CEO

Thanks, Richard. Glad to hear.

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### Richard Tse - Cormark Securities - Analyst

Yes, I had a question, in your absence. What parts of the strategy have been sort of put on hold? I'm guessing, there must be something, in terms of maybe the acquisitions? But maybe you can elaborate a little bit on that?





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

Yes, sure thing. Well, I haven't been absent. So I remained fully engaged in the business on strategy, key decisions. We set up an operating committee with myself, Gordon and John, and I'd really describe nothing has been on hold for the Company. The Company is bigger than any one person including me, and it's been full steam ahead, Richard.

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

Okay. And switching gears here to Actuate. Obviously, that's a new vertical for you guys. I think in your presentation, they are doing a run rate revenue of about \$58 million or so, on an annual basis. What do you guys see as the opportunity for that business over the next 12 to 24 months?

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

Well, maybe as John, is looking at the numbers. Look, we're very excited about bringing analytics into OpenText. We've -- well, in a lot of ways, we've come so far without analytics as an offering to our customers.

So first and foremost, we would like the standalone opportunity that Actuate brings just in and of itself, and we very much like the embedded market, which differentiates ourselves from maybe a Cognost and a business objects. Secondly, there a large-scale opportunity for us as we deeply integrate Actuate into our ECM offering, and into our iX cloud services, and we've delivered both of those initial integrations. So customers who has spent the last 5, 10 years of bringing lots of data into a content suite, now have a very robust tool to do dashboarding, forecasting, and Big Data analysis, and we've just recently delivered that integration.

The second integration that we provided at the end of the quarter, was an integration between Actuate, and our trading grid. So our many thousands of customers can now analyze supplier, product, performance and SLAs within the trading grid. So analytics is a real good opportunity for us. We've been at this business roughly 90 days now. We like the standalone opportunity, the embedded opportunity, and the integration opportunity, leading with content suite and exchange suite.

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**John Doolittle - *OpenText Corporation - CFO***

Yes, just on the numbers, Richard, on the services it would look like [\$14.5 million] for the quarter, as I imagine we took a revenue haircut of \$3 million. They are coming off a pretty good fourth quarter, and so this quarter was a little low. So I think that run rate that you mentioned is fairly low.

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

Okay. The reason I asked that question is that unlike GXS where there is credible cost synergies, I would have to think that this is probably more of a revenue synergy transaction. Not to sort of harp on that, so do you think this is a \$200 million-plus opportunity for OpenText in the next two years here?

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



It's certainly an opportunity, Richard. I wouldn't get down to a specific number. And look, in some ways, we're off to a little slower start than usual on an acquisition. We've been as you say, focused a bit more on getting those revenues synergies, and maybe the expense synergies coming out of the gate, because we do see that opportunity.

And like I said in my prepared remarks, by the end of the first year, they will be fully on, fully integrated, and fully on our operating model. But we are off to a little slower start on the expense side. Perhaps it's the trade-off of trying to do more integrations, and focus a little more on the revenue side.

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**Richard Tse - Cormark Securities - Analyst**

Okay, and I have got one last question here, for John probably. What percentage of the cloud business operating costs are fixed? And that's it for me. Thanks.

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**John Doolittle - OpenText Corporation - CFO**

Gosh, Richard, I will have to take that one, and come back to you. Off the top of my head, I don't know exactly what percentage of the cloud expense are fixed. So leave that with me, I will come back to you. Greg and I will get back to you.

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**Richard Tse - Cormark Securities - Analyst**

Great, thank you.

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**Operator**

Steven Li, Raymond James.

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

Thank you. Great to hear from you, Mark.

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

Thank you, Steven.

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

I had a few questions. John, Actuate had services and subscription revenues. Did I hear you correctly, that these are now part of the OpenText cloud revenues?



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**John Doolittle - *OpenText Corporation - CFO***

No, we're breaking Actuate out into the specific line items, Steven. That's not what I said. What I said was that, we had -- when we looked at the purchase price accounting, we were forced to take \$3 million revenue haircut on the deferred revenue balance that we inherited. But in terms of the underlying revenues, we're booking those to the appropriate line items.

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

So where would the services -- the Actuate services, where would it be recognized in if were the OpenText different revenue?

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**John Doolittle - *OpenText Corporation - CFO***

Yes, license would be in license, customer support would be in customer support. Cloud would be in cloud, if they had any.

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

PS would be in PS.

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**John Doolittle - *OpenText Corporation - CFO***

Yes.

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

Okay, great. And out of the 10 -- the seven figured here -- the press release says that were seven with GSX, which I suppose they were GSX and cloud, so there was no cloud non iX deals greater than \$1 million, correct?

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**John Doolittle - *OpenText Corporation - CFO***

That's true, yes.

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

And last quarter, there was one?

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**John Doolittle - *OpenText Corporation - CFO***

Greg, do you have that? I don't have that handy -- I don't recall there being one last quarter, Steven, but --



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

Okay, that's fine. And any other metrics you can share on cloud subscription deals that are non iX? Last quarter, I think you gave us a number of new customers in managed services.

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

Yes. Fair enough, Steven. We just -- part of the synergy or opportunity, probably a better word, between GXS and core OpenText on the acquisition, was being able to extend their managed services, which they do wonderfully to our enterprise customers. And we have officially launched that at scale across the organization globally, in select data centers in each of our geographies, they are to offer to our enterprise customers, those managed services. So we have been, in really earnest at it for about 90 days, and the initial reaction is very good.

I would expect to talk about a couple significant wins this quarter actually, when we get to our call in July. But we've been at it about 90 days. The interest is very solid. We're going to win customers this quarter for enterprise managed services and subscription, leveraging the GXS infrastructure. So still early days, and we will be talking about some wins this quarter on the next call.

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

Okay. And then, one last question for me. On your OpEx, I would have expected a bit more on [rival] costs. So for example, cutting back on bonus accrual given the revenue miss. But as your lower -- your [Canadian] OpEx to shrink a little bit given the FX moves, but did not see it. So can you give us a bit more color about these unique expense items you referred to, or maybe even quantify it?

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

Yes, well, a couple of things, Steven. So one thing on OpEx, you have to keep in mind, is the inclusion of Actuate. So as I mentioned from a headcount point of view, excluding Actuate and IGC, we're basically flat quarter-over-quarter. So we haven't been adding a lot of headcount. We've continued to focus on expense management, but you really do need to factor in each of the OpEx lines, the inclusion of Actuate.

You're right. We did see some benefit from foreign exchange. But as Mark said, we did have some one-time adjustments as well. And as an example of that, you read about the litigation we had with Box. We did not -- we had a settlement or a jury verdict, but we've not had a settlement with Box. So we've not booked the revenue, but we are carrying those costs, and that was several million dollars in the quarter. So that's an example of a one-time OpEx item, and also factor in Actuate.

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

Great, thanks.

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**Operator**



Philip Huang, Barclays Capital.

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**Philip Huang - Barclays Capital - Analyst**

Good afternoon. Just a few quick ones for me. First, given the margin this quarter, I was wondering, excluding what you deem as one-time items, what was your non-GAAP operating margin in the quarter?

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**John Doolittle - OpenText Corporation - CFO**

Well, it's in the release, Phillip, I'm not sure.

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**Philip Huang - Barclays Capital - Analyst**

Oh.

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**John Doolittle - OpenText Corporation - CFO**

Adjusted operating margin for the quarter was 25.7%.

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**Philip Huang - Barclays Capital - Analyst**

But that includes one-time items that you -- including the expenses related to the acquisitions, and other one-time items, right? Or I'm just wondering if you would exclude all those, what the -- (multiple speakers)

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**John Doolittle - OpenText Corporation - CFO**

We have not unbundled those things. I've highlighted a few of them, but we have not unbundled them to provide another view of operating margin. Those are all items that belong there. We're just pointing them out, from a timing and one-time point of view.

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**Philip Huang - Barclays Capital - Analyst**

Okay, got it. And then, regarding Europe, I think you mentioned in your opening remarks, that EMEA continues to be a tough selling environment due to the economy there. I was just wondering what visibility you might have, and what your expectations are on the improvement in this region?

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



Yes, Phillip. Thanks for the question. Mark here. Well, look, I think it's -- when we -- I think our Q just got filed, and you'll be able to see the trends year-over-year, and it will be -- you'll be able to see the EMEA trends. And so, that's why [they net to] EMEA.

Look, we have been building business in the sub Sahara and out of South Africa, Middle East, Eastern Europe, Russia, or rather CIS. And certainly, the Eastern European and CSI [effects] have bled into our [Doc] region which primarily is Germany. So our headlines for us, is FX had a \$30 million revenue impact in the quarter, partly transitioned to the cloud, and some of the macro effects in EMEA.

And EMEA has just got to work through those issues. I don't have a -- I can't really predict when those things will come back, if you will. I mean, maybe it's a quarter or two, but it's really a global macro issue right now.

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**Philip Huang - Barclays Capital - Analyst**

Right. Got it. Do you think that the trend so far has been sort of weak., it's been trending weaker than you might have expected a couple of quarters ago?

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

Well, I think -- if there's a bright spot, I would say that -- I don't know if I get this number precisely right, but I think that I read it in the FT, that close to 4,000 companies have exposure to Eastern Europe and Russia. And that effect has sort of now -- sort of bled through the system a bit, where we are kind of seeing the heightened effect of companies in Germany who have a CE, CIS exposure. So perhaps we're at the nadir of that, and of those companies what we call the Doc region, Germany, Austria, and Switzerland.

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**Philip Huang - Barclays Capital - Analyst**

Got it. And then, final question for me, just regarding the new pricing models. This is I think, the first full quarter, whereas you guys have the new models in place. I was wondering if you would give us a little bit more color on your customer's reaction, how they are responding to these pricing models so far? Whether you're seeing more take-up in one category, versus another versus your expectations? Thanks.

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

Yes, Philip, thanks for that question. I would say, we're not going to get into pipeline data today, but initial reaction has been very favorable. And I would say that subscription is probably leading ahead of managed services. Managed services is maybe a longer-term consideration, where the consideration take the bit more time, given the outsourcing of the infrastructure. But I would say from -- the leading subscription -- and I would put subscription managed services, and maybe SaaS, as one, two and three -- our first observations.

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**Philip Huang - Barclays Capital - Analyst**

Thank you. Got it. Thank you so much.

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**John Doolittle - OpenText Corporation - CFO**



Thanks, Philip.

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**Operator**

Kris Thompson, National Bank Financial.

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

Great. Thanks, Mark. Glad to have you on the call. At your user conference last year, the trade-in trade-up program was announced. Can you just give us an update on the program? Is it still live, and can you give us any indication of how successful it was or is?

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

Hey, Kris. Thanks for the question. We have been at it, oh, maybe four months, and it's generated interest, but hasn't really translated into revenue at this point. So certainly, it has generated interest and discussion, but really hasn't generated into revenue at this point.

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

Okay. Have you figured out why, or what your sales guys are saying about it?

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

Well, it's -- I think with the delivery of SP1, and SP1 was very focused on making it easier to upgrade, and to really deploy our suites. So that was the biggest input that we got was, try to take the cost -- upgrades are for all enterprise customers very expensive. We are not alone in that, and can you take the expense out, and maybe the professional services out of the equation as much as you can.

So and our one learning from the program was, can we get capabilities to make it easier for customers to upgrade. And not just to upgrade, but deploy into production. So SP1, which we delivered fully by the end of the quarter, has those capabilities in its package. So let's keep watching it, and I think SP1 will be helpful.

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

Okay. That's helpful. And John, the cash flow was at a record high. Did you mentioned the FX impact in your cash flow this quarter?

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**John Doolittle - OpenText Corporation - CFO**

I didn't mention the FX impact on the cash flow, Kris, but it would have been significant as well.



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

Okay. The reason I'm asking is, because deferred revenue on the cash flow statement was \$39 million, and same quarter last year, it was \$60 million. I'm just trying to figure out the delta there.

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**John Doolittle - OpenText Corporation - CFO**

Well, a big chunk of the deferred revenue impact was Actuate, right, this quarter.

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

Got you. I did remember you mentioned that. And just the last one then, while we are on maintenance revenues. How are those renewal rates, are you seeing existing customers swap into the subscription models?

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

Our renewal rates are maintaining a very strong, in the low 90%.

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

And there, any license customers swapping into subscription models yet, or discussing that?

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

For sure. For sure, Kris. As we talked about in the script, when I look at the license business -- I'll maybe just a moment to speak a bit about the license business directly. We really had three impacts to the business, foreign exchange. Second, customers either transitioning or considering transition to the cloud, and then year-over-year EMEA performance due to those macro issues we talked about. So those are the three things that sort of effected the license business.

But I also want take the opportunity to emphasize that we are more focused on recurring revenues that were 86% of our revenues in the quarter, and our top three metrics are recurring revenues, adjusted net income, and cash flows. But for sure, we had some customers who -- existing customers who are paying maintenance, who are considering transitioning to the cloud. And new customers, of course, considering a subscription model or a hosted model. And we think that's just fine, because we are agnostic to what revenue line they fall on. We're looking for the lifetime value.

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

Okay. Thanks for taking my questions, and get well soon, Mark. Thanks.

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





Thanks, Kris.

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**Operator**

Paul Steep, Scotia Capital.

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**Paul Steep - Scotiabank - Analyst**

Great, thanks. Good to hear you, Mark. I guess, the first question goes right to the cloud uptake point. You talked about that being a bit of a sales pause. Is it particularly around the license, is it -- how are we seeing that core ECM -- what's the impact on the core ECM business, in terms of sales cycle in the field?

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

Well, let me just -- I guess, note that again in constant currency, our cloud business was up 17% year-over-year, and that's a nice growth rate year-over-year. And on directly on the ECM side, we introduced OpenText core and full general availability for self-service registration and use last quarter.

And I don't have the total subscriber count in front of me. But I think in the first quarter, we're over 20,000, 25,000 subscribers to the service, in the first quarter of having OpenText core in production. Which is a full multi-tenant SaaS solution hosted in our cloud, in a public instance for those workloads appropriate for that type of deployment.

We're also offering OpenText core as a private deployment. That if you like it's capabilities, you like it's multi-tenancy, we will go host a private instance for you. So I think we have a very robust offering, both on-premise with Content Suite, and now a companion to that OpenText core on that SaaS offering. That helpful, Paul?

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**Paul Steep - Scotiabank - Analyst**

That helps. And how should we think about where the base is, in terms of moving to 10.5, and then getting ready to go to SP1 over time? How much of that core base has sort of migrated over at this point?

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

Yes, I don't have the install base metrics in front of me today, but there's still plenty of customers to be able to target -- install base customers to be able to target with SP1. I also think our new SAP process center is going to be very, very helpful. There have been some point vendors out there, recently acquired who have some capabilities around -- beyond just invoicing management.

So our content -- contact center within SP1 for SAP, is really a big new innovation for us, to go into our install base and the SAP install base. So I think point one, is that there's still plenty of install base customers to target with SP1 in general. Secondly, our new SAP release is really quite robust, and I think will be really interesting for existing and new extended ECM customers.



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**Paul Steep - Scotiabank - Analyst**

Great. And I guess the last one for me is, just around the management -- obviously, you can't offset all the FX impact I know of, in skimming the Q here, in terms of some of the restructuring activities you've taken efforts on. How should we think about rolling into Q4, which is traditionally the strongest quarter here, your ability to offset some of the foreign exchange hit that we saw this quarter?

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**John Doolittle - OpenText Corporation - CFO**

Well, I mean, Paul, we're doing everything we can to remain, as I said, focused on all of the OpEx line items, restricting headcount growth, making sure that travel is only for customer-facing meetings. But this is unprecedented, in terms of the foreign exchange volatility, and the euro has continued to be depreciate. It's been up a little bit of the last couple days, but it's down on a quarterly average. So it makes it very, very challenging to offset that depreciation. But we will continue to be focused on the bottom line, and doing whatever we can to manage our costs.

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**Paul Steep - Scotiabank - Analyst**

Great. Thanks, guys.

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

And Paul, the only thing I would add to John's good comments there, is that within Q3, we had a series of unique one-time expense items as well, that we don't see recurring in Q4 going forward.

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**Paul Steep - Scotiabank - Analyst**

Do we have a -- I am trying to piece those out as we go here. Do we have a total quantum on those? Like I know there is a number of them that are pretty unusual, that are not going to show up ever again. Do we have sort of a ballpark, on what that total is?

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

Well, we have got the litigation expense on Box, that's several million dollars. We've got the Actuate revenue haircut. We will see some of that in the fourth quarter, but that was \$3 million, won't be as much in the fourth quarter. Obviously, foreign exchange, depending of where the foreign exchange ends up next quarter, but those are examples of one-off items.

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**Paul Steep - Scotiabank - Analyst**

I guess, the last one, and I promise I will leave you then -- (laughter) is the bad debt piece. You flagged that as well, at GSX -- it looks like you might have been GSX. It's hard to tell to what it was.



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**John Doolittle - OpenText Corporation - CFO**

Yes, that's what it was. It was bad debt expense within GXS. That is another item. You are absolutely right, and we've had GXS for a year, and there are a handful of customers, where we did balances that crept up on the year market, and we have taken a provision there. And Mark and I are all over this. We're going to collect on those receivables, and we are trying to collect on as many as we can. And this won't be an recurring item. We've got a program in place to go after this.

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**Paul Steep - Scotiabank - Analyst**

Fully provided. Whereas the question was hadn't, but you fully took it in Q3, and we think as best we know it, it's in there.

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

Yes. For those customers -- where the balances were outstanding for a year, we took -- fully provided for those.

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**John Doolittle - OpenText Corporation - CFO**

Perfect. Thank you. Get well, Mark.

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

Thanks, Paul.

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**Operator**

Thanos Moschopoulos, BMO Capital Markets.

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

Hi, Mark, it's great to hear you on the call. And I'll start with a question for John. John, would you be able to provide the quarter-on-quarter impact of FX to revenue and EPS? Would you have those numbers handy?

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**John Doolittle - OpenText Corporation - CFO**

Yes, I will grab them, while you ask your next question.

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



Okay. It's sort of a related question, which is the sequential decline in cloud revenue from Q2 to Q3, was that [apparently] currency, or were there other factors that led to the decline?

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

Paul, I would certainly point to currency, Thanos, and of course, year-over-year in constant currency, up 17%. So I am not too concerned on a quarter-over-quarter performance, but rather the year-over-year performance.

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

Sure. And then, Mark, you commented on the macro environment in EMEA. How would you characterize the environment in other regions?

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

Well, I think the only other global comment, I would provide, is in emerging markets, with that -- for us that would include Brazil and South America, and India and China for us. But I think the only other comment would be, really looking at the fast growth markets for us, or emerging markets, that still aren't kind of reaching their full potential.

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**John Doolittle - OpenText Corporation - CFO**

Hey, Thanos, on the Q3 versus Q2 FX, I don't have those numbers in front of me. We've done those calculations. So right after the call, Greg will call you with those numbers.

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

Okay, great. And then, just the last one for me. On the last call, I think you talked about Actuate showing maybe a 10% to 20% revenue decline before it stabilized. We saw a sharper decline I think this quarter. And so, would that 10% to 20% decline still be the way to think about it, as we look out over the next year? Or might it be a little bit steeper, taking into account some other factors?

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**John Doolittle - OpenText Corporation - CFO**

No, I think we're still comfortable with the 10% to 20% decline. Like I said, there are a couple of factors that in play in making revenue number this quarter look particularly low. The purchase price accounting haircut, number one. They are coming off a strong quarter in the fourth quarter. So as we look out, we're still comfortable in the 10% to 20% range, Thanos.

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

Okay, I'll pass the line.



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**John Doolittle - OpenText Corporation - CFO**

Yes.

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**Operator**

Stephanie Price, CIBC.

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

Good afternoon, gentlemen.

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

Hi, Stephanie.

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

In terms of Q4, so looking at the fiscal Q4, I mean it typically is seasonally stronger. Could you talk a bit about what you're seeing in the pipeline, and how we should kind of think about it sequentially? And if it's different from historical?

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**John Doolittle - OpenText Corporation - CFO**

Yes, Stephanie, we are not -- as you know, we haven't got guidance out there for Q4. I have reaffirmed the target model. You're right. Q4 is sequentially stronger than Q3, and if you work your way through the model, that's what you would expect to see. But we're not giving out any pipeline data today. I think Mark already covered that.

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

Okay. And then, moving onto the acquisition environment. It looks like valuations are creeping up here. Can you talk a bit about the acquisition environment, and whether you can still find reasonably-priced acquisitions out there?

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

Hi, Stephanie, Mark here. Thanks for the question. You are right that, we've seen -- I think we have seen two things over the last quarter or two, is we've seen valuations go up. And we've seen some unusual buyers in the market as well, maybe not your traditional buyers. Nothing is going to change our view or our method, our sense of valuation here at OpenText. We classify ourselves as value buyers.



We prefer to do the hard and heavy lifting, to gain the value from an asset, and we continue to look in our traditional value ranges, and there is no scarcity of assets, if you will. But there is no doubt that, that valuations have crept up a bit. But I'll also add, that we've seen some nontraditional buyers come into the market as well. We will remain patient, and stick to our method of -- on our approach to valuation.

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

Great. And then, in terms of focus areas, are there any particular focus areas, you are looking at these days?

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

Yes, I tend not to get into specifics. We're not looking to expand the definition of EIM. We like the pillars, plus analytics. But we will look at filling with -- we typically start with a [white] space analysis, and we typically don't go for market share. So we kind of just start at a white space analysis of what we want to sell. But I, again I would emphasize, we're not looking to expand the definition of EIM. We like the pillars, plus analytics, and we continue to look towards the white spaces within those categories.

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

Great. Thank you very much.

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

Thank you, Steph.

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**Operator**

[Eyal Ofir], Dundee Capital Markets.

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Thanks, and good to hear, Mark, that your recovery is going as planned. So a few questions here So first off, just on -- going back to the cloud services line, you just touched about it. You noted that there's a bad debt expense, and I imagine if that there was a bad debt expense you would also -- sorry, a bad debt expense -- I'd imagine that the -- you would have also have impact on revenue due to some of these clients, obviously not recognizing the revenue from those clients. Do you guys have an indication of what the size of that impact is in the quarter?

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**John Doolittle - OpenText Corporation - CFO**

No, two different things. The bad debt expense that I was talking about was on historical receivables, where they were outstanding for a period of time. So not necessarily linked in any way, to whether or not we recognized revenue for the quarter.



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**Eyal Ofir - Dundee Capital Markets - Analyst**

Okay. So do you know if these -- (multiple speakers) -- these clients, you are not sure if they are live, you mean, still live?

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**John Doolittle - OpenText Corporation - CFO**

Well, it could be some, where we had revenues in the quarter. There could be others -- it could be disputes. There's not a direct link between whether or not, we took a bad debt provision, or whether or not we recognized revenue on that particular customer in the quarter.

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Okay. Okay. I just figured there was [probably a direct link]. Okay. A second thing, just Mark, in terms of obviously subscription revenue, you're talking about how some of the clientele is looking up, shifting to subscriptions or SaaS, or managed services. In the quarter, obviously this decision-making process could have actually delayed some customer decisions as well. Have you seen some of that, and to what extent? And also, is there any way to size up kind of -- I guess, the pipeline for the subscription model is, that you're seeing for the rest of the year?

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

Yes, Eyal. Thanks for the question. I'm not going to get into pipeline data today. As I said in my prepared remarks, the interest is pretty strong, and we, in the early feedback is very encouraging, 90,100 days after introducing those options. I mean, you look at our license business. There's some portion of it that will transitioned to a subscription, SaaS or managed services.

And we've been -- this is our third year now, offering cloud services in a cloud model. So we're well into this transition, if you will. But yes, I'm sure -- we -- the number one effect on the license was FX. Number two, consideration for the cloud, and then third, performance in EMEA. So no doubt, some customers are considering subscription or managed services over and on-premise. And we're agnostic to it. And again, a subscription after three years is economically more beneficial to OpenText

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Yes. And then, I'm assuming the subscription, obviously still sits in your cloud revenue line, versus the license revenue line?

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

Yes, it will, yes, it would

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**Eyal Ofir - Dundee Capital Markets - Analyst**



So for the -- going to 2016, should we start baking in a lower contribution from the license side, versus what your guiding to, for 2015? From a corporate target standpoint?

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**John Doolittle - OpenText Corporation - CFO**

Yes, like we said, we will be back with the target model for 2016 on the next call.

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Okay. And then just lastly for you, John, on -- in terms of cost -- I know a lot of guys asked this question on the call. You haven't given the specific numbers. But in the terms of the actual margins, obviously, the numbers were 25.7%. You're still guiding to the model, and of 28% to 32%, [on long end of this year]. Should we assume the transition back into the 28% to be fairly quick, or is this going to be over a two to three quarter time frame?

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**John Doolittle - OpenText Corporation - CFO**

Well, no, what I said specifically is, you're right. We're 25.7% this quarter. Year-to-date, we were higher. And so, when you build that all in, we're comfortable in operating margin between 28% to 32% for the year. So even though, we were lower this quarter, we been higher the first two quarters. And so, when you blend it all together, with our expectations for the fourth quarter, that's where we think we will land, in the 28% to 32%.

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Okay. And then, going forward beyond that time, obviously, you had some one-time charges here, that aren't going to be repeated. Are you still comfortable long-term, that 28% to 32%?

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**John Doolittle - OpenText Corporation - CFO**

Well, no, because what were going to do, is we're going to update the model for you on the next call. So I am not going to give you a 2016 guidance -- not guidance -- but I'm not going to give you the target model here today, but we will provide it on the next call.

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**Eyal Ofir - Dundee Capital Markets - Analyst**

Okay. That's fine. Thanks. I'll pass the line.

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**John Doolittle - OpenText Corporation - CFO**

Yes. Just while we are waiting for the next question, just for Thanos. I did grab those numbers for you, Thanos. So just here they are. In Q3 over Q2, revenue impact, negative \$17 million, and negative \$0.05 EPS.





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**Operator**

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

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

Well, thank you, everyone, for joining today's call. My concluding remarks will be pretty brief. I would just like to note that year-to-date, on a constant currency basis, revenue is up 30%, and adjusted EPS, up 15%. And over the trailing 12 months in constant currency, our license growth rate is 6%. Thank you for joining the call, and look forward to speaking soon.

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**Operator**

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

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