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OTC.TO - Q2 2016 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported YTD total revenues of $900m and YTD net income of $129m or $1.06 per diluted share. 2Q16 total revenues were $465m and net income was $87.7m or $0.72 per diluted share.

CORPORATE PARTICIPANTS

Greg Secord *Open Text Corporation - VP of IR*
John Doolittle *Open Text Corporation - CFO*
Mark Barrenechea *Open Text Corporation - CEO & CTO*
Steve Murphy *Open Text Corporation - President*

CONFERENCE CALL PARTICIPANTS

Phillip Huang *Barclays Capital - Analyst*
Richard Tse *Cormark Securities - Analyst*
Chris Thompson *National Bank - Analyst*
Paul Treiber *RBC Capital Markets - Analyst*
Paul Steep *Scotia Capital - Analyst*
Steven Li *Raymond James & Associates, Inc. - Analyst*

PRESENTATION

Operator

Welcome to the OpenText Corporation second quarter 2016 financial results conference call.

(Operator instructions)

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

Greg Secord ***- Open Text Corporation - VP of IR***

Thank you, Ben, and good afternoon, everyone. I'd like to welcome you to today's call. With me is OpenText's CEO and CTO, Mark J. Barrenechea, as well as our Chief Financial Officer, John Doolittle. Welcoming to the call as well, our new President, Steve Murphy. As with our previous calls, we'll read prepared remarks followed by a question-and-answer session. The call will last approximately one hour with a replay available shortly thereafter.

I'd like to take a moment and direct investors to the Investor Relations section of our website where we posted two PowerPoints that will be referred to during this call. The first is our quarterly supplement update on the financial results and the second PowerPoint is our annual strategic overview presentation from July, outlining our leadership positioning in the EIM marketplace with supporting stats outlining both our historical performance and cloud transition initiatives. I encourage all of our investors to download both presentations.

As of previous quarters, we've updated a summary table highlighting OpenText's historical trends and financial metrics, both PowerPoints and our trended financials spreadsheet are downloadable from the front page of the IR section of our website. OpenText will be hosting an Investor Day in New York, on Thursday, May 12. Details and official agenda will be posted on the IR section of our website in the coming weeks. If you are interested in attending or want to find out more information, please contact our Investor Relations team directly.

With that, I'll proceed to the reading of our Safe Harbor statement. Please note that during the course of this conference call, we may make statements relating to future performance of OpenText that contain forward-looking information. While these forward-looking statements represent our current judgment, actual results could differ materially from 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 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 the conclusion while making a forecast or projection as reflected in the forward-looking information, as well as 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 our press release that was distributed earlier this afternoon. Each of which may be found in our website.

We undertake no obligation to update these forward-looking statements unless required to do so by law. In addition to the conference call, we 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. And with that, I will hand the call over to John.

John Doolittle *- Open Text Corporation - CFO*

Okay, Greg. Thank you very much. Good afternoon, everyone. Welcome to the call. Let me go through the numbers and my references will all be in millions of US dollars unless I indicate otherwise. I will start with total revenue. For the quarter, it was $465 million, down 1% compared to $468 million for the same period last year and up 6% on a constant currency basis. Year-to-date, total revenue was $900 million, down 2% compared to $922 million for the same period last year, and up 5% on a constant currency basis.

Recurring revenue for the quarter was $383 million, down 2% year-over-year, compared to $392 million for the same period last year. Up 4% on a constant currency basis. Year-to-date recurring revenue was $767 million, down 3% compared to $788 million for the same period last year, and up 4% on a constant currency basis.

Now, to foreign exchange. In Q2 compared to the same period last year, our revenues were negatively impacted by $32 million. Adjusted operating income negatively impacted by $11 million, and adjusted EPS by $0.07. The negative effect of the $32 million by revenue type is broken down as follows; license, $8 million; cloud services and subscriptions, $7 million; customer support, $12 million; and professional services and other, $5 million.

Year-to-date, our revenues are negatively impacted by $65 million, compared to the same period last year. Adjusted operating income negatively impacted by $20 million and adjusted EPS by $0.13. The $65 million of revenue is broken down as follows; license, $13 million; cloud, $15 million; customer support, $27 million; and professional services and other, $10 million.

License revenue for the quarter was $82 million, up 9% compared to $75 million reported for the same period last year, and up 19% in constant currency. Year-to-date, license revenue remains stable at approximately $133 million, but up 9% on a constant currency basis.

Cloud services revenue for the quarter was $149 million, down 4% compared to $155 million in the same period last year, but up 1% in constant currency. Year-to-date, cloud services revenue was $297 million, down 4% compared to $309 million during the same period last year, but up 1% in constant currency.

Customer support revenue for the quarter was $184 million, up 3% compared to $179 million in the same period last year, and up 9% in constant currency. Year-to-date, customer support revenue was $370 million, up 2% compared to $363 million during the same period last year, and up 9% in constant currency.

Professional services and other revenue for the quarter was $50 million, down 14% compared to $58 million in the same period last year, and down 6% in constant currency. Year-to-date, professional services and other revenue was $100 million, down 14% compared to $116 million during the same period last year, and down 5% in constant currency.

Now, to gross margins. Licensed margins increased to 98% from approximately 95%, primarily due to lower third-party technology costs including the impact of informative graphics and lower sales of third-party products. Cloud services and subscription margin was 60%, compared to 62% in the same period last year. Increased expense in this period primarily attributed to non-recurring sales tax credits booked in Q2 of FY15 and increased cloud certification costs in FY16.

Customer support margin increased slightly to 88% compared to 87% in the same period last year due to a reduction in the installed base of third-party products and from organizational efficiencies. Professional services margins remained stable at approximately 24%.

Gross margins on a year-to-date basis; license, 96% compared to 95% in the same period last year; cloud, 60% compared to 62% in the same period last year; customer support, 89% compared to 87% in the same period last year; and professional services margins were stable at 24%.

Adjusted operating income was $172 million this quarter. It was up 12% compared to $153 million in Q2 of the last fiscal. On a constant currency basis, adjusted operating income was $183 million, up 19%. Year-to-date, adjusted operating income was $320 million, up 4% compared to $309 million during the same period last year, and a constant currency basis, it was $340 million, or up 10%.

Adjusted net income increased by 3% to $122.4 million this quarter, up from $118.8 million in Q2 of last fiscal and this was primarily due to a $20 million increase in adjusted operating income that was partially offset by higher interest and taxes. On a constant currency basis, adjusted net income was $131.2 million, up 10%. Year-to-date, adjusted net income was $225.6 million, down 5% from $237.4 million last year.

The decrease on a year-to-date basis is primarily due to higher interest expense of $19 million and an increase in the Company's adjusted tax rate from 18% to 20%. On a constant currency basis, year-to-date adjusted net income was $241.8 million, up 2%. Even though our GAAP rate this quarter is quite low, we expect to continue to see an adjusted tax rate of 20% for this fiscal year.

Adjusted earnings per share was $1.01 per share on a diluted basis, compared to $0.97 for the same period last year, up 4%. And on a constant currency basis, adjusted earnings per share was $1.08, up 11%. Year-to-date, adjusted earnings per share was $1.85 on a diluted basis compared to $1.93 for the same period last year, down 4%. On a constant currency basis, it was $1.98, up 3%.

On a GAAP basis, income from operations was stable at approximately $110 million. Year-to-date, income from operations was $186.5 million, down 13% from $213.6 million in the same period last year. And the decrease is due to lower revenue of $22 million and higher operating expenses of $20 million, primarily due to increased special charges.

Net income for the quarter was $87.7 million, $0.72 per share on a diluted basis, compared to $74.3 million or $0.60 per share on a diluted basis in Q2 of the last fiscal. Year-to-date, net income was $129 million, or $1.06 per share on a diluted basis compared to $138.9 million or $1.13 per share on a diluted basis in the same period last year.

There were approximately 121.8 million shares outstanding on a fully diluted basis for the second quarter of FY16 and 122.2 million shares outstanding on a fully diluted basis here to date. We repurchased 0.3 million common shares during the quarter and 1.5 million common shares year-to-date under our NCIB program.

Year-to-date, this has had minimal impact on EPS, approximately $0.01, due to the timing of when the shares were canceled. On a weighted average basis, the shares canceled impacted total diluted shares outstanding by $0.2 million for the quarter and $0.8 million year-to-date, and we've repurchased approximately $65 million of $200 million program.

Daegis was acquired on November 23, 2015, for a total consideration of $23.3 million, or $22.1 million net of cash acquired. The acquisition had no significant effect on revenue or earnings.

Operating cash flow for the quarter, was approximately $124 million, an increase of 13% compared to $110 million in the same period last year. The increase was primarily due to active working capital management program which contributed $11 million in operating cash flow compared to Q2 2015. Driving cash flow improvements continues to be a top priority for us.

Now, to the balance sheet, at December 31, 2015, deferred revenues were $339 million, compared to $386 million at June 30, 2015, and this decrease is the result of normal seasonality. Cash and liquidity, our cash and short-term investments balance at December 31, 2015, was $742 million, compared to $711 million at June 30, 2015, and $543 million, at December 31, 2014.

Our overall liquidity position continues to strengthen with growing cash flows and balances and conservative leverage ratios. Accounts receivable was $279 million, at December 31, 2015, compared to $284 million, at June 30, 2015. Date sales outstanding were 54 days, at December 31, compared to 53 days, at June, and 50 days, at December 31, 2014.

Now, just a few comments on our FY16 external target model that's published on the IR website. I am pleased with our margin performance this quarter. We're just two quarters in and our target model is annual with two more quarters to go to complete our fiscal year. The fact is, there is still a lot of economic uncertainty out there and the currency markets remain unstable. The Company has its most significant product release plan for the second half and investment is required to support version 16, and Mark will expand on this.

So even with a strong first half of the year, we're maintaining our FY16 non-GAAP operating margin target of 30% to 34% and expect to execute to the high-end of that range. Tax update, as previously announced and disclosed last quarter, we received the first of two expected draft notice of proposed adjustments on July 17, and we continue to expect to receive the second draft notebook. There is no additional news at this stage. On February 8, the Board declared a cash dividend of $0.20 per share for shareholders of record on March 10, 2016, payable on March 31, 2016. With that, I will turn it over to Mark.

Mark Barrenechea ***- Open Text Corporation - CEO & CTO***

Thank you, John, and welcome, everyone. As I usually do, let me convey our key messages in the introduction and then do a deeper dive into those topics that require more information or insights after my introduction.

The team delivered a strong Q2, both financially and strategically. I'm pleased with our progress. John has provided the financial detail and I'll get into a few additional items here in a moment. I recently announced a series of executive promotions at the very top of the organization and I welcomed the addition of Steve Murphy as President of OpenText. Steve will be on the call a little later. Release 16 is on schedule.

We are making select key investments immediately and in the coming quarters, help capture the Release 16 opportunity. The data opportunity is large, transformative and expanding. The most recent notable expansion, being the rise of machine to machine transactions, and EIM will play a key role in those machine to machine transactions as the platform to manage a single source of truth. Some call this the Internet of Things.

Customers are looking to OpenText for leadership in digital. This includes the EIM, cloud, hybrid, analytics, the Internet of Things, managing their own digital transformative agendas and many other items. We have earned a right at the table with the Fortune 10,000 and we are shaping our own future. We have made significant progress in Forrester Waves and Gartner Magic Quadrants. We are in six Waves and lead in three. We are in seven Magic Quandrants and lead in three. The industry is beginning to recognize our leadership in EIM.

There is economic uncertainty, which ultimately is an opportunity for OpenText. Companies tend to behave in one of three ways in uncertain markets, I tend to find. They either freeze, they retreat, or they invest. We are investing and we see that opportunity really as twofold.

First, customers need to go faster on their digital transformations and with Release 16, we have the opportunity to be their strategic partner for the next decade. Our investments will center on those customers and market share gains including enablement, readiness, upgrades and competitive replacements. Second as an acquirer with M&A as a core part of our business model, assets should become more actionable and we should accelerate and we can accelerate the growth of our platform breadth and depth.

As I commented on the last earnings call, our Q2 pipeline looks strong and we executed to that. As we look into Q3, we expect typical seasonality. What is Q3 seasonality? It's pretty simple for us. For the majority of our customers, it is their first fiscal quarter, and thus, they allocate more time on planning and alignment for spending. It is a beginning of their budget cycles.

As John noted, we are on target to both our internal FY16 operating plan and our external target model and we are not updating our external model today. Our business model, the OpenText Intelligent Growth System, is our guide. M&A will continue to drive the majority of our revenue growth and net income and cash flow expansion, coupled with relentless focus on organic growth. Over last 12 months, cash flow from operations was near $0.5 billion.

These are the key messages and let me dive a little deeper into a few of them. On Q2, the team delivered a strong quarter. The quarter shows the potential from our customers on the multi-year digital transformation market opportunity. We have built a powerful operations engine, net income and cash flow business, and this quarter, shows its potential.

As for our financial performance in the quarter, in constant currency year-over-year, total revenues were up 6%, recurring revenues were up 4%, maintenance revenues were up 9%, cloud revenues were up 1%, licensed revenues were up 19%, PS revenues were down 6% but balanced with solid margin of 24%. With this revenue performance and our operations engine, solid execution and our May 2015 restructuring now behind us, we deliver strong margin, income and cash performance.

Please recall, this previously announced restructuring was to align the organization to our hybrid on premise cloud view of the world in digital strategy. The teams have executed well on the restructuring and I'm pleased with where we planned it. Adjusted operating margin was 37%, adjusted operating income was $172 million, up 12% year-over-year, and an ending cash balance of $726 million. Highest quality adjusted operating income in our history.

On to the cloud. At the risk of repeating myself, our customers see the world as hybrid and you can see that, actually, in the financial results within the quarter. And that is customers also want to run the right workloads in the right place, regardless of the physical location, on prem, in the OpenText cloud or in a third-party cloud. Ultimately, as we state in our 2020 aspirations, I see our on premise and cloud services businesses with equal weightings. Quarters may vary, but as we go to our 2020 aspirations we see this with equal weightings.

Four years into cloud services transition, and as we've stated previously and have delivered to, we expect licensed revenues to remain constant on an absolute dollar basis as we expand the Company operating margins and net incomes. We deliver to this for the last three years. We delivered again this quarter.

I want to look back a little bit. In Q1 of FY13, we introduced our first cloud services revenues of $46 million and 29% adjusted operating margins. In this quarter, cloud services revenues totaled $149 million, and adjusted operating margins were 37%. As you can see 14 quarters later, the transition has worked. Our financial model is working. FY16 Q2 is another strong data point. Hybrid is working. Recurring revenues is working. And we expect to deliver another solid fiscal year in this transition to a hybrid world.

When you have a chance, please read our quarterly supplement investor presentation in which you will see our customer wins and their narrative from the quarter. We brought on board some blue-chip customers in the quarter. Elcom, Braun, National Commerce Bank, Shiseido, GTAA, City of San Diego, Schneider Electric, ENGIE formally known as GDF Suez, Ajuntament de Barcelona, Pirelli and Banque De France. It was a very nice customer win quarter for us.

There are key buying considerations included digitalization, information governance, information security, new regulations that affect financial services, agriculture and a lot of other industries, managed services, or as I like to say, do it for me, and rapid application delivery. We added over 25 new managed service customers in the quarter and our total managed service customers are now above 900.

We also delivered $57 million of new MCV bookings, which will turn to monthly revenues in the coming quarters. MCV, as a reminder, stands for minimum contract value. These are multi-year guaranteed contracts that once a customer is live, we begin to bill monthly or quarterly for the service.

We have decided to discuss this most meaningful aspect, which is new value. For example, if we have a $1 million contract over three years and renew that contract for $1 million over three years, the new MCV value is zero. If we renew and expand the contract for $1.2 million, the new MCV is $200,000. New customers are new MCV. Within the quarter, we delivered $57 million of new MCV.

Also, ECM, applications and analytics, these product lines performed well in the quarter. Americas was 56% of our business, EMEA 35% and APJ 9%. As for verticals, financial services, technology, services, public sector and healthcare were all greater than 10% licensed contributors. Great to see healthcare up there above 10%.

Next, I'd like to speak to the executive announcements that we've recently made. Executives need to be ruthless on prioritizing to the highest impact items in time management everyday. I just completed my fourth year with OpenText and as I look to the future on how to continue to gain market scale, fill white spaces, grow revenues and cash flow with speed and purpose through our own innovations and smart capital allocation, strengthening our executive talent and prioritizing my time are quintessential elements to our continued success.

To that end, I'm very pleased to introduce Steve Murphy, President of OpenText. Steve joins us from Oracle where he was leading the $9 billion North America services business. Steve has an MBA from Harvard and a Bachelors of Science in Mechanical Engineering from UC Davis, which means he's an engineer, which implies he is wicked smart and very fact-based. Global enterprise software businesses are complex and Steve brings the scale and experiences we need at OpenText.

Steve's role is new. He's directly responsible for all revenue and all the organizations required to deliver revenue. This includes all selling teams, pre-selling teams, maintenance revenues, marketing, partners, customer support and our professional services organizations. It's a delight to work with Steve and it will be exciting to watch his many contributions to the Company over time.

Muhi Majzoub was promoted as well to EVP and is responsible for all products, cloud services, commercial cloud and corporate IT. One team for all products and services, on premise or in the cloud. John Doolittle was promoted to EVP as well and is responsible for finance, human resources and all the operations of the business. Gordon Davies was promoted to EVP as well and is responsible for legal services and corporate development.

Steve, Muhi, John, Gordon are my direct reports and this is what I refer to as the top of the organization changes. That's what changed in the organization. I'm delighted with the exceptional quality of this team and my wider executive leadership team and their spans of influence. Further, this alignment laser focuses me on strategy, M&A, products and competitive differentiation, customers, our key stakeholders and the strategic operations of our business. I can already feel the effect of it.

Let me move onto Release 16. Let me put my CTO hat on for a moment and talk about enterprise information management digital in Release 16. Obviously, we could spend a lot of time here, but let me just provide the highlights. Our vision is to deliver a singular platform for the management, analysis and exchange of enterprise information. We call it enterprise information management, or EIM, for short. One platform to manage all information. One platform for

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predictive information analysis. One platform to exchange information through business networks, business to business, cloud to cloud, and now, machine to machine.

For enterprises, ERP was the most important system over the last 20 years, as it automated structure transactions. Data employee, pay this invoice, schedule this job and was the single source of truth for a transaction. Very important. Remains very important today. And it served large businesses well, they reduced G&A expenses, closed the books, paid employees, et cetera.

In our view, EIM is the most important enterprise system for the next 20 years. Why? The value is in the information, not the transaction. And we believe that all enterprises are ultimately information companies, whether you be in financial services, insurance, agriculture, picture industry, ultimately, all enterprises are ultimately information companies. If they are not, they'll face the dilemma of digital or done.

EIM automates information; global loan processing, food health and safety, trillions in digital commerce. We have been building and buying the components of EIM and will continue to do so. It took ERP 30 years to mature into three meaningful companies; SAP, Oracle, Salesforce. EIM is still in the early stages, currently fragmented across a couple thousand companies.

We are leading in shaping the market and remain significant white spaces, verticals, geographic, size considerations and consolidation opportunities in front of us for our M&A strategies. Over the last two years, as an example, we've added business networks and analytics to the definition of EIM.

Release 16 is rich in functionality, wider in scope, more deeply integrated and includes business networks and analytics. It runs both on premise and in the open text cloud and as a reminder, we own our own cloud and we operate our own cloud. This is very, very important. It's offered as a managed service and includes new vertical capabilities in healthcare, public sector, retail, consumer package goods, media and entertainment, financial services and our new transportation and logistics modules, to just name a few.

We will see -- we expect to see key customer buying considerations aligning with Release 16, digital top of the list, information, security and governance, analytics, managed services or do it for me, self service is no longer good enough, the Internet of Things. Another key buying consideration is the rapid and lightweight application building and deployment that -- for applications that are both information and process oriented like loan processing, chase management, contract management, to name a few. With Release 16, we believe all existing customers will find strong benefit by upgrading. There'll be a set of competitors when stacked up against Release 16, will simply look more like a feature, not a company.

We are also building a culture of sustained innovation from Release 9 to Release 10, aka Red Oxygen, to Release 16 now, Blue Carbon, and of course, our next project, BAM. Release after release, our products get stronger and stronger, more functionally rich and more deeply integrated. We're excited about our new and differentiated OpenText Release 16 product cycle that approaches us in the coming quarters. We see Release 16 as the world's first digital platform and as I said earlier, at the end of the day, enterprises are ultimately information companies and OpenText can help customers achieve digital excellence.

Let me wrap up my comments. I'm pleased with the Company progress and our financial results in Q2. We remain on target for our internal FY16 operating plan and our external target model. We are not updating our external target model today. As John stated, we expect to be at the high-end of our adjusted operating margin target range for FY16.

There is economic uncertainty, which ultimately, is an opportunity for OpenText. Companies tend to behave in one of three ways in these uncertain markets; they flee, they retreat, they invest. We're investing in the success of Release 16. We are making key -- and some of those key investments, which we're going to make immediately and over the coming quarters, are centered on customers to help capture that opportunity.

We strengthened our leadership team with recent promotions and the appointment of Steve Murphy. The alignment laser focus is me on strategy, M&A, products, competitive differentiation, customers, stakeholders and the strategic ops of the business. We expect traditional Q3 seasonality. Our business model, the OpenText intelligent growth system, is our guide and M&A will continue to drive the majority of our revenue growth and net income and cash flow expansion in the coming years, coupled with relentless focus on organic growth.

We have an important second half in front of us, starting with the kickoff of our Global 2016 Information Tour in two weeks. We have the opportunity to continue the digital transformation and Release 16 conversation with thousands of customers, partners and employees. I'm personally looking forward to giving the keynotes in Tokyo, Sydney, Paris, Munich and London over the next 30 days.

John will be meeting with investors in Toronto later this week. I'll be presenting at the Morgan Stanley Tech Conference in San Francisco, on March 2. And please save the date for our annual Investor Day in New York City on May 12, where myself and members of the Executive Leadership team will present our outlook on the strategy for the business. Before I open the call to questions, let me introduce Steve Murphy and hand the call over to Steve. Steve?

Steve Murphy *- Open Text Corporation - President*

Thank you for the warm welcome, Mark. I'm extremely excited to have joined OpenText. It is been just over 30 days and I'm really impressed with the quality of the team. We have a world-class organization with the best EIM suite of products in the marketplace.

Let me give you my first impressions of the Company. First, something that's very important to me is that the culture of the Company is one of customer first. Whatever it takes to help the customer, whether that's during an escalation, or during an upgrade, or during a transition. Second, my philosophy is that customers don't buy from companies but rather they buy from people. I've observed first hand that all around the world customers like us and trust us. It's a huge competitive advantage.

Third, as an organization, we are margin focused and this is a good fit for me. I am operations oriented and I see lots of opportunity to balance cost discipline with real growth initiatives. And then fourth, we're big enough to leverage our scale but small enough to be agile, which gives us a major advantage over some of our larger more cumbersome competitors.

Customer is my number one priority and I'd love to be out in front of them getting to know them. Over the next 60 days or so, I plan to get face-to-face with as many customers as possible and will be traveling all over North America, Asia, Europe, UK and Australia, to do so. When I'm back home, I'll be working out of our US headquarters in San Mateo, California.

I'd also like to describe the breadth of the role of President, which I've assumed. I have functional responsibility across the entire spectrum of customer facing operations for OpenText, including marketing, professional services, presales consulting, license sales, cloud sales and technical services. The holistic nature of the role allows me to have a laser focus on healthy and sustained organic growth for OpenText.

Before I pass it back to Mark, I want to say again just how enthusiastic I am about the opportunities at OpenText. The Executive team is a great group of individuals with a get things done mentality. They don't let egos get in the way. We're in a unique position to help customers realize concrete return on investment with digitalization and I look forward to be a major part of this. I hope to meet many of you who are on the call at our New York Investor Day in May. Back to you, Mark.

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Thanks, Steve. I really appreciate it. I would like to now turn the call over to the operator for your questions.

QUESTION AND ANSWER

Operator

(Operator instructions)

Phillip Huang, Barclays.

Phillip Huang *- Barclays Capital - Analyst*

Thanks, good afternoon. Congrats on the solid set of results. It should certainly help to address any lingering concerns on a cloud transition strategy. But I was wondering if you could give us some additional color or perhaps an update on how much of the revenue growth on the cloud side is now coming from what you would consider as new revenue sources rather than existing customers switching from older platforms?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Phil, thanks for the question. On cloud specifically, in constant currency, we're up 1% year-over-year. We brought on board I think 24 or 25 new customers in the quarter, over 900 managed service customers now. And there are a variety of growth opportunities for us in the cloud. I think we have a geographic opportunity in EMEA for both our value added network, our on demand messaging and managed services.

I also think we have more vertical opportunity in the cloud. A transportation and logistics module coming out. Some of our new healthcare capabilities for on demand messaging. So, the majority of our revenues are from existing customers. We've added new customers in the quarter and we do have a handful of meaningful growth factors for us out there as well; geographic, vertical, and functional.

I also want to note that our cloud strategy is one of not substitution. We've been very focused on driving for new spend in new revenues, whether that be taking a license and hosting it, taking a license and providing managed services. So to that end, being able to provide managed services back to our traditional ECM and BPM customers is also a growth factor for us. Look, and within the quarter, we had a good license quarter as well. It's either revenue can move between the lines. So, the opportunity is strategic, the transformation is very successful and I think we've got some very well defined growth factors to go after.

Phillip Huang *- Barclays Capital - Analyst*

Right. That's very helpful. Along the same line, given what is happening at some of your competitors, Dell, HP, can you give us an update on any changes observed perhaps by your sales team? Have you done any analysis, perhaps, on potential benefits as a result of disruptions at some of your competitors? Thanks.

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

I put the competitive landscape into probably three buckets and with market conditions, as I'd just say between -- well, let's just call it market conditions annually 2016, I'd look at the competitive landscape in three categories. I think we're going to have some very established incumbents, such as IBM and Adobe, that will be our main competitors, if you will. (Inaudible) will have a competitor, maybe Pega, and BPM. And Release 16 is going to be that much differentiated.

I think you have a handful of competitors as well from properties like ReadSoft, Cofax, Documentum, Interwoven, that have not invested in EIM, have not invested in digitalization, that we're going to look at for competitive replacement programs. Then you probably have a third category of those companies that are going to want to look a lot more like a feature with Release 16, such as the jive and the boxes of the world.

With Release 16, our competitive differentiation is going to get that much stronger. Our analysis shows three big buckets of the IBM and Adobe's of the world and the secular competitors. Secondly, those who have not invested in the IM and digital, which we're going to look at for competitive replacement programs. And then, a handful of others that are going to look a bit more like a feature verses a company when Release 16 comes to market.

Phillip Huang *- Barclays Capital - Analyst*

Thanks very much.

Operator

Richard Tse, Cormark Securities.

Richard Tse *- Cormark Securities - Analyst*

Mark, could you talk about the go-to-market strategy for Release 16 when it comes to existing and new customers or any major programs that you are planning here and maybe even just a bit of color on that?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Sure thing, Richard. Thanks for the question. We weren't planning to go into the detail today. I'll touch on a couple of things. In the beginning of Q4, we'll do our launch events and we'll talk about those specific programs. Certainly, there are things we can help existing customers with and that is an upgrade.

We've spent a fair amount of time learning from Red Oxygen of how to be able to provide a upgrade capabilities. We have potentials of upgrading customers into our cloud as part of an install base program. So bucket number one, investments. Bucket number one will be going into the install base and looking at every opportunity. We think there's an opportunity in every customer to upgrade making it easier, faster and potentially, in our cloud.

For new customers, it will be centered around competitive replacement programs and probably industries, a handset of verticals. More detail to come. We'll talk about the specific programs when we do our actual launch in beginning of Q4.

Richard Tse *- Cormark Securities - Analyst*

As far as the M&A environment goes, I was wondering if you could talk to the opportunities today, the pipeline, how robust it would be and perhaps a little bit of color on valuations in the market?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Sure thing. Look, we've talked over the last couple of calls that here in FY16, we expect to do multiple and meaningful transactions in the year and nothing has changed our view on that. Without getting into vertical, geographies, pillars and that sort of thing. The pipeline is rich and volatile markets. Assets theoretically become more actionable on valuation. Our methodology hasn't changed. Our sense of a valuation hasn't changed. And nothing has changed my view that we can't execute two multiple meaningful transactions on the year. And as markets become more volatile, it's an opportunity for OpenText.

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

Last one for me, just wondering if you could maybe comment on your progress in regards to cross-selling products among your base? You've obviously expanded through acquisitions at both your product and your customer list. Is that something that you're focused on now and perhaps give us a bit of color on that progress or are you really waiting for Release 16 to do that? That's it, thanks.

Mark Barrenechea - ***Open Text Corporation - CEO & CTO***

Fair enough. Thanks, Richard. My best way to describe this is show me one buyer and I'll show you one sales force. Right? And we intentionally designed the field coming into 2016, to be focused -- really kind of three sales forces, if you will, or going to three buyers. I guess we'll call it three buyers. One is the information platform, the other is analytics and the other is the business network. And they have their quarters and they have their goals and they've got lots of opportunity to go hunting.

I think one of the things that Steve and I are working on and designing is as we get into 2017, is more cross-sell opportunity. But the key word here is probably going to be verticals. So, right now, we're targeting three buying centers. The business network sells to business network, analytics sell to analytics and the information platform sells to information platform.

Analytics is an opportunity everywhere for us. That's pretty clear. Those are our mandates coming into 2016, as we look into FY17 and Murphy studies the organization and we think of account segmentation, we'll think more of cross-selling. I know analytics top of the list and probably more of a vertical focus as well.

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

Great. Thanks, guys.

Operator

Chris Thompson, National Bank.

Chris Thompson - ***National Bank - Analyst***

Thanks. This question is for Steve. Welcome, first of all. I think it's probably fair to say that OpenText has had fits and starts with a formal Oracle partnership over a number of years. Is there now renewed hope for a formal agreement similar to the one with SAP now that you're now on board at OpenText?

Steve Murphy - ***Open Text Corporation - President***

Thanks for the question. What I can say is we've had great success with SAP and it's certainly reasonable to think that success could be modeled elsewhere. There are some strengths I bring as far as relationships with folks at Oracle right now, but Oracle also has got a way that they go to market that has a different view of third-party products and how they are willing to sell those. So it's something that we'll take a look at but I'm certainly not willing at this early stage to make any commitments around certainly the next 6 months to 18 months how much progress we can make there. It's something worthy of taking a look at for sure.

Chris Thompson *- National Bank - Analyst*

Okay, so it's fair to say it's not a priority for you then, in the near-term?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Thanks for your question, Chris. (Laughter).

Chris Thompson *- National Bank - Analyst*

Mark, one for you then. In your opening commentary, you talked about customers setting their budgets in this March quarter. Are you seeing any spending caution so far when you're talking to your customers looking into this quarter?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Chris, I haven't seen in the pipeline at this point budgets being deferred or budgets shrinking. I haven't seen that behavior yet. It feels like typical Q3 seasonality. Not going to shrinking budgets, disappearing projects, we haven't seen that yet. We are only one-third through the quarter as well, but it feels more like typical Q3 seasonality.

Chris Thompson *- National Bank - Analyst*

Okay, good stuff. I'll hop back in the queue. Thanks a lot, guys.

Operator

Paul Treiber, RBC Capital Markets.

Paul Treiber *- RBC Capital Markets - Analyst*

Thanks very much. I wanted to touch on cloud revenue. It has been flattish for the last number of quarters despite the strong cloud MCV or bookings. Could you speak to some of the moving parts in cloud revenue? And then, when should we think about cloud bookings translating into stronger headline cloud revenue on a constant currency basis?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Paul, thanks for the question. Maybe we'll just talk about the parts a little bit. I just like to remind us that the asset classes for us in the cloud are more like GDP growers. So EasyLink as an on demand messaging platform, GXS as a B2B van as well. These are not 20%, 40% growers, right? We intentionally went for the infrastructure, the value, gave an optimized to income. So I just wanted you to remember that we've onboarded lower growth assets. We see potential to grow them.

Second, this is really in three layers. We have our value added network, we have our on demand messaging and we have managed services. And we have opportunity in EMEA for ODM and van. We have opportunity in the enterprise for managed services. A couple of other data points, we run in the mid-90%, John, on renewal rates in the cloud. So on the on prem license side, we're in the low 90%, and in the cloud, we're in the mid-90%. So, we have to make up for that to be able to grow.

Managed services, we're experiencing I'd say two to three quarters, two to four quarters from a booking to full revenue, if you will. It takes a while to be able to be able to onboard -- to bring the infrastructure in, onboard a customer, be able to get all their transactions flowing over the network and time from booking to revenue, is multi-quarter. Obviously, you want to work on that and be able to bring that in as well. Paul, that's another variable in the equation as well.

On the MCV number, that will translate to revenues in the coming quarters. With that said, in any given quarter, revenue can move between lines in our hybrid strategy. And in Q2, we had a strong license quarter. Doesn't change our view of recurring revenues or managed services, but it can move between lines.

John Doolittle *- Open Text Corporation - CFO*

The other variable I was going to point at and maybe you did already, Mark, but the duration of these contracts. We're talking on average three-year contracts. You've also got to factor that in as a variable as well.

Paul Treiber *- RBC Capital Markets - Analyst*

Thanks. Just wanted to ask one more question of Steve. Could you elaborate on what you feel personally is the opportunity that you see for OpenText in EIM over the next several years? And in regard to your own goals and priorities at OpenText, in what ways do you feel that you can improve OpenText's performance going forward?

Steve Murphy *- Open Text Corporation - President*

Let me give you a few things to think about, but I'm not sure I can do complete justice to the question. I do think that having been on the job for a month, a couple of things I'm ecstatic about. One is, this is a healthy, stable company that has done a great job of focusing on margin. You see that in the numbers.

When I think about some of the acquisitions we've made and the assets we have, embedded analytics, for instance, there are a lot of places where that -- someone had asked earlier about upselling and cross-selling. There certainly is a lot of potential to take our global scale across the thousands of people we have that fade to markets and sell embedded analytics into the customers we already do business with.

With Release 16, I'm not going to go into detail on some of the features or functions around things like entity modeling, but there are some really fantastic pieces of technology in there. I expect us to do the same with that. Those are a couple of places where I can already see we've got a differentiated technology that no one else has, we've got a sales force that's very capable and we'll take those pieces of technology and weave them into the solution we sell.

Paul Treiber *- RBC Capital Markets - Analyst*

Thank you, I'll pass it along.

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Paul, I'll emphasize one thing. As we continue this conversation on cloud and the quarters to come, the organization is very focused on managed services, both in the enterprise, analytics and business network. We think ultimately, that is one of our great opportunities. We nicknamed the 3M strategy of maintenance, margin and managed services. And for managed services, the more customers we can bring into our infrastructure, the stronger our cloud becomes. So, you'll hear me continue to emphasize managed services and the one metric that we're publishing behind it, which is new MCV that ultimately, will turn to revenue over a series of quarters.

Operator

Paul Steep, Scotia Capital.

Paul Steep *- Scotia Capital - Analyst*

The first one, a clarification. Mark, you've talked a bunch of times on the calls as John about strategic investments for the back half of the year. Maybe you could talk about the significance or the size of these investments, you've highlighted customers. Is this a ramp in additional headcount or is this more related to R&D and marketing spend, marketing spend around the tour? And then, I have a quick follow-up.

John Doolittle *- Open Text Corporation - CFO*

A combination of all of those things, Paul. As we look at Release 16, it's sales folks, it's sales support staff, it's engineering folks, it's marketing. So, we need to invest across the board in order to launch this release. It's not one item and I'm not going to get into the specifics of how many here or how many there, but we baked into the analysis that we've given you in terms of the operating model for the back end of the year.

Paul Steep *- Scotia Capital - Analyst*

Okay. That's clear. Mark, we're just slightly over a one-year anniversary in Actuate, so happy anniversary. Can you reflect a little bit on the performance to date? It was a company with great assets and maybe some executional challenges on a prior strategy. What's your take at year-end? And we've talked a bit some of the opportunity but where are we standing here today on February 9?

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Paul, great question. I'll start with, what a gem. We're just delighted to have Actuate as part of the OpenText family. And one year in, we're right on our internal plan. And the opportunity -- there's a standalone opportunity and then there's an integrated opportunity. The standalone opportunity is embedded analytics.

Actuate is just the best asset, the best analytic platform out there for embedded analytics. We provide the daily reporting for Bank of America branch management. We do the daily reporting for Deutsche Bank's mortgage business. We recently won the next generation embedded analytics platform at NetApp. And this is just an incredible opportunity having Actuate as part of OpenText.

The next horizon is to bring Release 16 to market where analytics is embedded everywhere and that's going to be exciting to watch. It's part of the content suite, process suite, experience suite. It sits now on top of the business network as part of Cloud 16, the business activity index, we're on target for that in our April release that we showed at Enterprise World. So, that's the next big opportunity is to bring Suite 16 and Cloud 16 to market. So, a gem of a product, the people are a delight, we are on our financial plan, the standalone opportunity in embedded gets more credibility with OpenText. And then, with Cloud 16 and Suite 16, we're going to just see it integrated everywhere as the next step.

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

You made me think of one last one that I will slide in. You've talked a bunch on this call, more than any time in the past I can recall, but MTM and IOT as an opportunity area. What have customers been bringing that up to you or is that a vector that you're identifying as an area growth? Thanks very much.

Mark Barrenechea - ***Open Text Corporation - CEO & CTO***

Yes, it's actually the first time I'm bringing it up. We won two platforms last quarter that are actually machine to machine transaction generators, if you will, and all the information is being stored in our EIM platform. And so, it's going to become a stronger focus for us with Release 16 that it's not just humans putting in their unstructured data, it's going to be machines putting in unstructured data. So I think we've begun to figure it out a little better. We've had a few customer wins and we got some more product obviously, to go build and deliver, but it's worth highlighting as a growth factor.

Operator

Steven Li, Raymond James.

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

A quick one from me. Your DSOs very strong in Q1, but in Q2, you had 54 days. Probably the worst it has been in a couple years. Anything going on there, John, and would you we expect that to revert as soon as Q3?

John Doolittle - ***Open Text Corporation - CFO***

I wouldn't call it a trend, Steven. I'm focused on DSO. I've talked to my new partner, Steve, about that as well. Our DSO's within the, call it old OpenText here, are very good. We have some opportunity to reduce DSOs within GXS and we are really focused on that. So that's going to be -- that's on the top of my list of things to look at and as well, we're focused on our days payable. And the easiest way to drive cash or raise cash, is to drive it from your balance sheet and we're going to do that. So look for improvements.

Operator

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

Mark Barrenechea *- Open Text Corporation - CEO & CTO*

Thanks, Ben. I appreciate it and thanks everyone for joining us today. We have an important second half coming up in front of us and it's about our execution. I'm looking forward to being on the road with the team for our information tours and personally giving with the team three keynotes and connecting with a lot of customers in the coming weeks.

Hope you'll be able to join us at the Morgan Stanley Tech Conference. Better join John later in this week in Toronto and please save the date for our annual Investor Day in New York City on May 12. It will be an important update as the Executive team presents the strategy on the business. Thanks for your time today and I look forward to speaking and seeing many of you soon. That concludes today's call.

Operator

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