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Conference Call Transcript

OTC.TO - Q3 2011 Open Text Corp Earnings Conference Call

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Welcome to the Open Text Corporation's third quarter fiscal year 2011 financial results conference call. At this time all participants are in a listen-only mode. Following the presentation we will conduct a question-and-answer session, instructions will be provided at that time for you to queue up for questions. (Operator Instructions) I would like to remind everyone that this conference call is being recorded today, Wednesday, April 27, 2011 at 5 PM Eastern time. I will now turn the conference over to Mr Greg Secord, Vice President, Investor Relations. Please go ahead.

Greg Secord - Open Text - VP- IR

Thank you, and thank you for joining us everybody. Please note that during the course of this conference call we may make projections or other forward-looking statements relating to the future performance of Open Text or its subsidiaries. These oral statements may contain forward-looking information and actual results could differ materially from the conclusions, forecast or projection in the forward-looking information. Certain material factors or assumptions were applied in drawing a conclusion or while making a forecast or projection as reflected in the forward-looking information. Additional information about the material factors or assumptions 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, are contained in form 10-K and form 10-Qs of Open Text as well as in our press release that was issued earlier today. Now, with that I will turn the call over to Paul.

Paul McFeeters - Open Text - CFO

Thank you Greg. I will highlight the results of our third quarter. Total revenue for the quarter was \$263 million, up 24% compared to \$213 million for the same period last year. License revenue for the quarter \$67.8 million, up 37% compared to \$49.5 million reported for the same period last year. Maintenance revenue for the quarter was \$143.1 million, up 15% compared to \$124.4 million for the same period last year. Services and other revenue in the quarter was \$52 million, up 34% compared to \$38.8 million in the same period last year. Gross profit for the third quarter before amortization of acquired technology was 73% which remained consistent compared with Q3 last year.

Adjusted operating margin increased 11% to \$64.1 million this quarter from \$57.8 million in Q3 last year. Adjusted net income increased 30% to \$52.5 million this quarter from \$40.3 million in the third quarter last year. Third quarter adjusted EPS was \$0.90 on a diluted basis, up 29% from \$0.70 per share for the same period year ago. The adjusted tax rate for the quarter is 14%. We expect the FY '11 adjusted tax rate to be between 12% and 14% and cash taxes to be in the 5% to 10% range.

Net income for the third quarter in accordance with GAAP was \$35.8 million or \$0.61 per share on a diluted basis compared to \$13.1 million or \$0.23 per share on a diluted basis for the same period a year ago. There were approximately 58.4 million shares outstanding on a fully diluted basis for the quarter. Operating cash flow in the quarter was \$82.3 million compared to \$78 million in the same period last year, an increase of \$4.3 million. On a year-to-date basis operating cash flow was \$171.3 million compared to \$115 million in the same period last year, an increase of \$56.3 million. Absent the impact of cash paid related to special charges, year-to-date operating cash flow was \$188 million compared to a \$140.4 million for the first nine months last year.

Turning to the balance sheet. At March 31, 2011 deferred revenue was \$268 million compared to \$230 million as of June 30, 2010 and accounts receivable was \$150 million compared to \$132 million at the end of last year. Days sales outstanding were 49 days as of March 31, 2011 compared to 50 days at the end of last year. And 52 days at the end of Q3 last year. The sequential effect of foreign currency movement on adjusted EPS was a negative \$0.01. We closed the acquisitions of Metastorm and weComm during the quarter. Total consideration net of cash acquired for these two acquisitions were \$168.7 million and \$20.2 million respectively. These acquisitions, together with StreamServe were \$0.06 accretive to our EPS for the current quarter. There's no change to our pre-tax adjusted operating model for this quarter, we expect our annual operating net margin model to continue to be in the range of 25% to 30%. The full details of our operating model are available on our website and in our press release. Now I will turn the call over to John.

John Shackleton - Open Text - President and CEO

Thank you Paul. Hello everyone and thank you for joining us today. I am pleased with our third quarter results. We had strong revenue in all geographies and are on track to meet our annual goals. Our pipeline visibility and predictability are improving and we are pleased with how our pipeline management is progressing. As Paul mentioned we generated \$67.8 million of license revenue in the quarter. Geographically Americas were responsible for 51% of revenue, Europe 40%, with Asia-PAC at 9% despite the situation in Japan. Of the license revenue approximately 46% came from new customers and 54% from our install base.

We had 14 transactions over \$500,000 and an additional 10 transactions over \$1 million. This compares to 8 transactions over \$500,000 and 5 transactions over \$1 million a year ago. Average transaction size was approximately \$250,000, slightly down from the same quarter last year, which reflects our building pipeline of new customers. The largest transactions in the quarter came from public sector, financial services, IT services and consumer goods.

Once again, compliance based solutions were responsible for many of the large deals. But we're also seeing an increase in productivity driven solutions, such as our ERP integration offerings and most recently the BPM products from Metastorm. Examples of customers that bought in the

quarter included Loblaw, Canada's largest food distributor. They purchased the Metastorm enterprise suite to help facilitate and accelerate Loblaw's enterprise transformation initiative. The goal is to help manage, optimize and control their global business operations.

MMM group, a Canadian program management planning, engineering, and geometric firm purchased Open Text Lifecycle Management and Open Text Everywhere. Open Text will provide users across the organization with a central repository to store and share information and help improve collaboration over multiple locations and projects. DLM will deliver records management functions and capabilities to provide full Lifecycle Management around the company's engineering documents.

Spin Master, a children's entertainment company purchased Open Text Media Management and extended ECM for SAP. This solution will assist Spin Master with their new product development process, replacing manual tasks and improving collaboration with partners. Media Management workflow capabilities will ensure that their production, reuse and publication process work seamlessly together.

One of the largest global pharmaceutical and healthcare companies, located in New Jersey, purchased the Media Management Hosting Service offering from Open Text. The company will use Open Text Media Management as its central repository for rich media marketing content. And finally, North Carolina Department of Transportation purchased Open Text extended ECM for SAP solutions.

In Q3 we saw license revenue broken down by vertical as 18% from financial services, 17% from service industries, 15% from technology, 13% from public sector, 12% from natural resources and base materials, 8% from healthcare, 8% from consumer goods and 6% from industrial goods. Despite government spending cutbacks we continue to see strength with international governments, and are pleased with how this vertical is building in our pipeline. Approximately 40% of our license revenue in the quarter came from partners and resellers. Our SAP relationship is performing well.

Also, our close working relationship with Microsoft had positive impact in the quarter and is yielding a significant number of opportunities in the pipeline. We continue to work closely with Microsoft on application integration, joint sales and marketing efforts. The Oracle relationship is progressing with Oracle also influencing some key transactions in the quarter. We continue to build on the source code that Oracle shared with us last year. This code sharing agreement is part of an effort to integrate tighter ECM functionality from Open Text in Oracle's Fusion middleware and provide joint selling opportunities.

We closed the quarter with a combined sales force of over 400 quota carrying sales executives, up from 364 last quarter. With the addition of Metastorm sales representatives, we have more than sufficient capacity to support our annual plan. Maintenance retention rates in the quarter remained the same, in the low 90s range and I am pleased with the customer retention rates from our recently closed acquisitions. On February 18, we announced that we had closed the acquisition of Metastorm, recognizing the importance of BPM to both our ECM and mobility strategies. We plan to integrate Metastorm's products into the Open Text ECM suite.

The industry analysts tell that BPM is a fast growing market and we're cross-training our sales teams to take advantage of the high growth expectations from this business. The integration of the StreamServe continues to progress well and we are encouraged by the uptake of the StreamServe products within our existing base.

In the quarter we also acquired London-based weComm to further our mobility strategy. WeComm has key technology that will allow Open Text to help its customers create and deploy mobile apps cost effectively across various mobile platforms and devices. This technology will advance our position in the mobility market.

The acquisition of weComm is also yielding value for the organization. Mobile apps have been deployed at several Open Text events on numerous devices all driven from a common code. In addition to mobility, things are going well with our Social Media for the Workplace offerings. Recognition for the use of our social collaboration systems by the G20 has led to numerous additional sales opportunities around the world. Beyond government agencies, corporations are also using Social Media for the Workplace. For example, U-Haul has deployed Open Text Social Media to help manage its U Car Share and U-Box programs.

Turning to product announcements in the quarter. We announced a new release of Web Experience Management. This offering enables marketing organizations to extend digital media to online audiences, including tablets and smartphone users. This is the first offering utilizing the integrated weComm technology. We also announced the availability of Open Text Application Governance & Archiving for Microsoft SharePoint 2010. This provides integrated end-to-end management of SharePoint 2010 sites across an entire enterprise.

We also announced that Metastorm's M3 modeling application will be delivered by the Microsoft Windows Azure platform. This, along with Open Text's current Azure based offerings are key contributors to our Cloud strategy. Example of customers Cloud wins this quarter include a

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large North American financial institution using Content Server with Records Management in the Cloud for content publishing of its public facing website. A global fast food chain with large amounts of digital storage to manage is using Open Text Media Management in the Cloud as its central repository. And finally, at Canadian Provincial, a government agency selected Open Text Content Lifecycle Management to manage its content in a fully hosted Cloud environment. At our Content Days in Europe, we saw a record turnout with over 1,000 in attendance to see the product suites including offerings from our StreamServe, Metastorm and weComm groups. We are encouraged by the recent up-tick in customer interest in workflow, document output and extended ERP integration. While we continue to see compliance as a strong business driver, demand for productivity-centric applications like these have created additional opportunities in our pipeline.

In the quarter we conducted a study with [AIM] which analyzed the benefits and efficiencies of Content Management. This study highlighted how productivity of administrative staff can be increased an average by 33% through the use of workflow, scanned forms and automated data capture. Another interesting discovery was the improvement efficiency for providing employees with smartphone access, estimated to be a 20% to 25% productivity gain. The full report is available for download from the Open Text website.

Gartner just released the 2010 ECM market share overview. And we are pleased to see that our position has increased once again and we are now neck and neck as the number one ECM vendor in the world.

Turning to the outlook for the remainder of FY 2011. The industry analysts are telling us that they expect ECM license revenue to grow an average of 7% to 11.5% through 2015. While we're not providing specific guidance, we feel confident with our targets and business model. From a seasonality perspective, we worked through the year on refining our pipeline management process. As a result, Q3 has been much smoother than last year and we are expecting these efforts will continue to have a similar smoothing effect on Q1 and Q3 next year.

So, in summary, it was a good quarter with strong license revenue results. I am encouraged by the growth and consistency in our pipeline and we're tracking well to our annual profitability model for the rest of the year, and remain positive on the outlook for fiscal 2012. With that I would like to open the line for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Mike Abramsky, RBC Capital Markets.

Michael Abramsky - RBC Capital Markets - Analyst

John, you talked earlier about demand. Just kind of focusing on demand and you made some comments in your press release about improvement -- and this is the second quarter, it's also, I think, the strongest license, if I'm not incorrect, you have had in 3 years. So can you just give us a sense of what are both the tailwinds and headwinds that we might see from you in terms of demand?

And also are you seeing any government weakness because obviously that is been a focus here and abroad. Then finally on the issue of demand, are you expecting more uptake from your cross-selling opportunities from your acquisitions or from partner as a driver or from the BPM opportunity? Three questions there.

John Shackleton - Open Text - President and CEO

You are correct on the licenses. This is probably the fastest-growing license revenue we have had in a couple of years. And really we are seeing it in all geographies, probably the tailwind is government surprisingly, even with the government cutbacks et cetera, we are still seeing significant growth in this area. Mainly because they are focusing on productivity, where they're having to reduce budgets, do it with less people, so business process automation, et cetera is important. So obviously we are helping in that.

We are seeing the Social Media and Mobility applications pick up. And we also are seeing, as you mentioned, cross-selling opportunities both from the StreamServe, using StreamServe in our customer base, as well as with weComm, and Metastorm selling into our customer base.

Michael Abramsky - RBC Capital Markets - Analyst

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So, how -- what inning are we in? Or can you give us some sense of the scope of the cross-selling opportunities from Metastorm and StreamServe ahead? And when you kind of expect that to ramp up?

John Shackleton - Open Text - President and CEO

We are just in the beginning, but the pipeline is building nicely. We are very pleased with the demand that we are seeing, particularly with the StreamServe is doing very, very well.

Michael Abramsky - RBC Capital Markets - Analyst

And then on your partner revenues. I think you were talking that last analyst day about Oracle shaping up and now you started to comment that there were some key transactions in the quarter. Could you be a little bit more specific and maybe use a couple of examples and also talk about -- do you see that as significant as SAP or kind of number two?

John Shackleton - Open Text - President and CEO

What I would say today is that SAP is pretty much right on target. We had a good quarter with them, continues to go very well. Microsoft is probably picking up also in that. We had a very good quarter with Microsoft, working with SharePoint integrations applications for SharePoint.

And the Oracle -- we're still building on the source code that they built and we are expecting in next quarter and quarters after that to see that start picking up. It has been much more of a still in a development phase from Oracle at this standpoint. But I would say that -- so, SAP continuing as we expected, Microsoft slightly better than we've expected certainly this past quarter, and we still have hopes that the Oracle is coming along nicely.

Michael Abramsky - RBC Capital Markets - Analyst

Okay and then lastly John. You saw a little bit more dilution from Metastorm than I think maybe The Street was expecting. And just wondered if you could talk a little bit about how that might play through?

Paul McFeeters - Open Text - CFO

Mike, it's Paul. You mean on dilution in margin --

Michael Abramsky - RBC Capital Markets - Analyst

Yes.

Paul McFeeters - Open Text - CFO

Overall -- even StreamServe, we've only been operating for 5 months. So between StreamServe and Metastorm if I can answer it that way. It would have a margin contraction of just over 1%.

John Shackleton - Open Text - President and CEO

And on that Mike we would see, given the potential growth in this area, it will probably take 12 months to 2 years to get on to the full margin, our operating model, but we expect to see some certain growth with that. Also within that Mobility space we are looking at increased investment in R&D. If you look at our R&D numbers, they are little higher than normal because we do see this Mobility application as an opportunity for further growth as well.

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Operator

Scott Penner, TD Newcrest.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Just a few questions around the acquisitions. Paul, I assume it's going to be in the 10-Q as well, so could you just give us what the revenue was? If you can break it out, StreamServe and Metastorm?

Paul McFeeters - Open Text - CFO

StreamServe was \$16 million and Metastorm was \$12 million.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Okay. So that Metastorm \$12 million is quite a bit higher than what you would expect just doing a run rate calculation. Is that when the revenue fell during the quarter?

Paul McFeeters - Open Text - CFO

That's right answer to that is correct. To your point Scott, it's a good point. I would normalize it going forward.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Okay and then just to be clear, John. I think you said that the Metastorm, I guess given the growth potential, you are looking at a 12-month to 24-month time frame to get in on your operating model?

John Shackleton - Open Text - President and CEO

That's right. While we would see the usual synergies around back office and senior management, we do want to focus a little more on their sales and marketing and give them some room for growth in that area.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Okay. And then just before I leave that, I believe last quarter you said that Metastorm the percentage of license revenue was in-line or a little bit higher than you guys do in the core business. Is that safe to assume that, that held true within that \$12 million?

Paul McFeeters - Open Text - CFO

That's right, Scott.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Okay. Then also, Paul, if you could walk us through what the outlook is on any sort of integration charges or really what is left to come as far as charges going forward?

Paul McFeeters - Open Text - CFO

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Yes, we would have probably another, I would say between approximately \$5 million to \$6 million going forward, in terms of future charges. And then -- just give me one second on the quarter -- for the quarter, this Q3, we had about \$5 million of cash payments on the charges to date. Restructuring was about \$4.4 million.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Yes, that \$5 million to \$6 million going forward, does that include what you would anticipate for Metastorm or is that just what you have got arranged so far?

Paul McFeeeters - Open Text - CFO

No, I would put that as what we anticipate. To John's point, in Metastorm and somewhat in StreamServe, we have senior management and back-office integrations whereas the sales forces are remaining somewhat intact and even R&D. That's why it's going to take longer to get on the operating model.

Scott Penner - TD Newcrest/Waterhouse Securities - Analyst

Okay thank you for that. And then John you mentioned your comments on a little gentler seasonality in Q3 and then looking forward. I'm just trying to divine what that could mean for the normal Q4 spike, presumably that means it's not going to be the level it was last year. Are we back to looking at 10% to 15% up in a Q4 in the core business?

John Shackleton - Open Text - President and CEO

I think you are right, Scott. If you go back 2 years which we consider the traditional model, I think you're looking at 20% to 30% up in Q4.

Operator

Richard Tse, Cormark Securities.

Richard Tse - Cormark Securities - Analyst

Just a quick question here, or a couple of quick questions, first on the M&A environment. So with all these acquisitions, are you guys going to take a bit of a breather right now for the integration or do have an active acquisition strategy going forward still?

John Shackleton - Open Text - President and CEO

The acquisitions of Metastorm and StreamServe, et cetera, are going very well. They tuck under pretty closely, so you will see other acquisitions coming, Richard.

Richard Tse - Cormark Securities - Analyst

Okay. In respect to the discussion on Cloud. You guys are talking about this more. Can you give us a sense of what percentage of your revenues today is represented by Cloud versus what it was last year?

And also, comment on any customers that have shifted over to this model? Actually I'm not clear on where it sits on your income statement. Is in the license number or is it in the service number?

John Shackleton - Open Text - President and CEO

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I will let Paul answer that. Let me start though with giving the market. Up until this year, it has been very minimum revenues from Cloud. And what we have really seen as well, we have seen a lot of our existing customers very interested in it, asking if we have that capability. They're have been very few that have taken us up in that.

What we have found in the beginning is also customers that use our products behind their firewall have now offering Cloud applications. So for example a pharmaceutical company that uses our products for research and development behind the firewall now using their clinical trials functions in a Cloud service. So we are seeing a number of customers that will use both models and it's only recently that we are beginning to see customers looking for just the Cloud model. I will let Paul answer on the accounting side.

Paul McFeeters - Open Text - CFO

Yes, Richard, the actual revenue on just the peer hosting -- in some cases our hosting is only, it's not the SAS model per se, we're hosting the application so the license there will still be in license revenue. As we have -- as we're introducing more SAS type pricing that will be included in the maintenance line.

Richard Tse - Cormark Securities - Analyst

Okay. And just, I guess on some of the previous questions. If you look at the cost base today and I'm looking sort of R&D, sales and marketing, G&A. We shouldn't really expect any down-tick in any of those numbers for the next couple of quarters given your commentary about the 1- to 2-year integration period?

Paul McFeeters - Open Text - CFO

That's generally true. Yes, Richard that would be a generally true statement. I will make one other comment on a one-time pickup charge this quarter on our long-term incentive plan, which is really a 3-year plan which is ending this fiscal year. We had a one-time take of about \$4 million, that won't repeat next quarter.

Operator

Kris Thompson, National Bank Financial.

Kris Thompson - National Bank Financial - Analyst

John or Paul, maybe can you talk about the gross margin on your services revenue, it looks like it is just under 16%. I have not seen it that low for about 4 years.

John Shackleton - Open Text - President and CEO

That's right. Usually it's in the 18% range and it was a little low this quarter, mainly US, as we are looking at moving some folks and doing some cross-training in the areas of SAP and Microsoft. We have strong demand in both those areas and so we have been doing quite a bit of training in that area. In Europe, the margins have continued to be high, but this past quarter was low in the US.

Kris Thompson - National Bank Financial - Analyst

So those should accelerate back towards the 20% range?

John Shackleton - Open Text - President and CEO

Yes, we should have those back to 18% over the next couple of quarters.

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Kris Thompson - National Bank Financial - Analyst

Okay and I guess just on the ESPs are at \$250,000. You said it reflected a pipeline. Could you just elaborate a little bit on that because again have not seen that as low for awhile.

John Shackleton - Open Text - President and CEO

Yes, so usually on the -- it's usually around that \$300,000 mark for the last couple of years. But it typically, if you look at the model, what we see with our customers is they'll typically do a pilot in the \$100,000 to \$200,000 range to begin. Then after 6 to 9 months they will buy more again in the \$200,000 to \$500,000 range and then after a year or 2 years they will be looking at the larger transactions.

I think the lowering reflects, as you noticed, usually our existing customers to new customers is usually in that 70-30 range, so this year -- this quarter we have had a much higher new customer range which is in these pilots and pilot projects that they've been doing.

Kris Thompson - National Bank Financial - Analyst

Okay. That was going to be the next question. That makes a lot of sense. So that's why John, you sound very confident in your pipeline and the outlook for the remainder of this year.

John Shackleton - Open Text - President and CEO

Well both that, we are seeing lots of newer customers coming in. But also the pipeline management that we're looking at where we're looking at 2 or 3 quarters out -- that gives us time to do field marketing, reactions to if a market looks a little weak and so that is giving us the confidence of seeing the transparency there as well.

Kris Thompson - National Bank Financial - Analyst

Okay and I think as of last quarter there were still two remaining government contracts that were pushed out. Did you close those and is that some of the reason for the license strength this quarter?

John Shackleton - Open Text - President and CEO

Yes, that is correct. But we do see additional government contracts as well.

Kris Thompson - National Bank Financial - Analyst

And then just high-level here, Tom was talking about the China opportunity at one of your conferences last year. Can you just give us any anecdotal evidence of what you guys are doing in China and where you think that revenue profile is going to start to make a material difference?

John Shackleton - Open Text - President and CEO

I think a couple things. One is we are seeing interest in China and other Asia-PAC countries. Cloud would obviously be a natural for them. And we are seeing significant interest, it hasn't turned -- it's turned into a little bit of revenue, but not a lot at this point, but we are also seeing other countries, Russia, Brazil and India are also picking up in the opportunities in these areas as well.

Kris Thompson - National Bank Financial - Analyst

Okay, my last one here for Paul. Just on the CapEx this quarter. Can you remind us how much was for the new Waterloo building and how much is remaining so we can get a better idea of your maintenance CapEx going forward?

Paul McFeeters - Open Text - CFO

If I could give you a to-date number, we spent about \$17 million on the building and that total will be \$24 million and the balance of that will be in Q4 and Q1.

Operator

Stephanie Price, CIBC.

Stephanie Price - CIBC World Markets - Analyst

Just on the cross-selling. Could you talk a bit about where you are with rolling out Metastorm into your sales force?

John Shackleton - Open Text - President and CEO

So what we're actually -- is that we're keeping the Metastorm sales force focused on their traditional selling into -- they're usually selling into functional managers rather than CIOs. And so we are continuing to have them do that, but we are also looking at some of our larger accounts in both North America and Europe and then bringing them into those accounts with our salespeople so it would be like a joint selling effort in those large accounts. So we are testing it that way first.

Stephanie Price - CIBC World Markets - Analyst

Okay. And then in terms of geographically, can you talk a bit about where you're seeing the most momentum and also if there was any impact from the situation in Japan?

John Shackleton - Open Text - President and CEO

Good, that's a very good question. So one is on the momentum side, this quarter -- the good news is, it was across the board. Europe had a good time, a good situation. The Canadians very strong, and Canada this time. And while Japan obviously with the effect there -- that had an effect with the Japanese numbers, but we are were able to make that up with Australia and the rest of Asia, were able to make up those numbers.

So -- and even in Japan, even though it was the last month obviously was nothing, they actually the prior two months did very well. So it was fairly short term. And while we did have some damage to facilities, all our staff were okay and they're, I think it's going to take a few quarters to get back. But they are very resilient and working towards getting back to normal.

Stephanie Price - CIBC World Markets - Analyst

Okay, great. And in terms of the partnerships, Microsoft you mentioned you saw a positive impact in the quarter. Could you talk a little bit about what you're seeing year-over-year? And also the partnership in general where it is, the stage it's at right now?

John Shackleton - Open Text - President and CEO

Yes. I think year-over-year we have seen significant growth in the partnership in joint selling opportunities. Both work around SharePoint, where it is basically, we provide the white space and the additional functionality that SharePoint doesn't have. But also building applications on top of SharePoint that allow access to our SAP applications or to our Oracle applications that provide users of SharePoint additional functionality. On both those areas, both SharePoint, DoD certification for Records Management and interfacing to SAP and Oracle are the 2 areas we see the most growth. Often fairly significant size transactions.

Operator

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Paul Steep, Scotia Capital.

Paul Steep - Scotia Capital - Analyst

Just on the write-down in deferreds Paul for Metastorm and StreamServe for next year. How much did you reduce the deferred maintenance line?

Paul McFeeters - Open Text - CFO

The balance sheet was for \$2.2 million. On total, I think this quarter was only about \$250,000. So for the next year it would count about \$2.2 million. I put a schedule in the press release on that I think.

Operator

Sera Kim, GMP Securities.

Sera Kim - GMP Securities/Griffiths McBurney - Analyst

Just on the pipeline. Is it more concentrated to certain vertical markets like the market that you've seen recent strength in, or have you been able to pick up strength in other vertical markets with the recent acquisition?

John Shackleton - Open Text - President and CEO

I would say that the weakest market was government. Particularly like in Europe where they were having with the recent elections et cetera. What we have seen is that pick up significantly. But I think the good news is, it's pretty much across all verticals. We have seen financial services strong, teleco technology area strong, utilities come back. So it's pretty much across the board.

Sera Kim - GMP Securities/Griffiths McBurney - Analyst

Okay great. And what percentage of the pipeline would you say is for compliance-related solution versus the productivity-related applications you were talking about earlier?

John Shackleton - Open Text - President and CEO

I think this is what's interested me more -- usually is like a 60% or 70% compliance, 30% what would I call productivity. I am seeing the productivity as picking up. So I would say maybe if it was 60% before, I would see it be moving closer towards the high 50%.

But we are seeing that product -- which we feel for growth and ROI invest for our customers, we see the productivity areas is almost the next maturity step if you will. So we're quite pleased to see that growing.

Sera Kim - GMP Securities/Griffiths McBurney - Analyst

Okay, when you talk about productivity are you including Mobility and Social Media in there as well?

John Shackleton - Open Text - President and CEO

Yes, very much so. We are seeing particularly in governments, we are seeing Mobility and Social Media as a major use as a productivity gain for them.

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Sera Kim - GMP Securities/Griffiths McBurney - Analyst

And have you seen meaningful revenue from those two areas yet or is that kind of something we can expect it in 2012?

John Shackleton - Open Text - President and CEO

Yes, it's actually started. So we saw it a little bit in Q2, but we saw it much more in Q3.

Sera Kim - GMP Securities/Griffiths McBurney - Analyst

Great. And just last question. What percentage of your existing customer base would you say has upgraded to the ECM 2010? I know it's still pretty early, so over what time period do you think that people will be upgrading?

John Shackleton - Open Text - President and CEO

They are either upgrading or have notified us that they will be upgrading, something like 60%, much higher than I expected, that they will be upgrading within the next 12 months.

Operator

Eyal Ofir, Canaccord Genuity.

Eyal Ofir - Canaccord Genuity - Analyst

Just in general, I have a quick question for Paul on some of the OpEx line items. You noted that there was about \$4 million of one-time expense in the quarter. Was that embedded into one line item or was that across the board?

Paul McFeeeters - Open Text - CFO

It was across the board. It was about -- only a little bit cost of sales but a \$1 million R&D, sales and marketing \$1 million and G&A \$2 million.

Eyal Ofir - Canaccord Genuity - Analyst

Okay. Then the other question was in terms of the R&D, obviously that increased sequentially pretty significantly, and you guys talked about a part of that being from the acquisition but also a part of it being from specific to investment in the Mobility side. Can you just specify how much of it was related to acquisition versus the R&D related to Mobility?

Paul McFeeeters - Open Text - CFO

Are you asking how much R&D has gone up because of the acquisition itself?

Eyal Ofir - Canaccord Genuity - Analyst

Yes, I'm just trying to understand the split between how much you got from the acquisitions, but also how much you internally invested into the Mobility side.

Paul McFeeeters - Open Text - CFO

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I'll come back to you on the acquisitions specific of that question, just give me one moment. The acquisitions overall in the quarter were about \$22 million across the board. And just trying now to get the breakup between lines. On Mobility, in the norm rate John, I think the increase in Mobility has pretty much been in the last 3 to 6 months.

John Shackleton - Open Text - President and CEO

That's right.

Paul McFeeeters - Open Text - CFO

For -- breakout Eyal, we'll get back to you on the specific breakdown.

Eyal Ofir - Canaccord Genuity - Analyst

And then on the Mobility front. This is going to be an ongoing R&D initiative that we should be expecting, so there's no one-time items that we could maybe --

John Shackleton - Open Text - President and CEO

I think you should see a little bit. If I recall off the top of my head. Paul will get back to you on the specific numbers but I think it is like a 1.5% increase. I would see it for the next couple of quarters, but then should get back to normal.

Eyal Ofir - Canaccord Genuity - Analyst

Okay that's good. And then John for you, from a strategic go-to-market strategy perspective when you look at emerging markets, you talked about China earlier in the call. But obviously emerging markets could become a very meaningful growth opportunity for the Company. Is there a strategy you are using within your own sales organization or are you looking to some of your reseller partners to drive that up for you?

John Shackleton - Open Text - President and CEO

We are actually looking out to our resellers in all of the markets except Brazil where we -- with the acquisition of Vignette, they had quite a strong presence down there, so we do have a strong team down there. But even in Latin America we are working with our partners down there as well.

Eyal Ofir - Canaccord Genuity - Analyst

Okay, and are you starting to see some of that build in your pipeline or is your pipeline still turned to the traditional markets?

John Shackleton - Open Text - President and CEO

No, we are seeing that in the pipeline. Brazil has grown significantly this year. Probably over 200% growth this past year in Brazil alone.

Operator

Brian Freed, Wunderlich Securities.

Brian Freed - Wunderlich Securities - Analyst

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I've got two quick questions. The first on the competitive landscape, as you look at the peers, I think EMC had a 32% year-over-year decline on license revenue. 10% overall. Can you talk a little bit about what you are seeing with your major competitors and what seems to be driving your share gain?

John Shackleton - Open Text - President and CEO

If you look at the traditional competitors, IBM, EMC and then SharePoint would be the other, yes, we have seen increases against both EMC and IBM from a competitive standpoint. I think some of it is the focus is that all we do is ECM. So that we are not in a hardware vendor we are not in the professional services business trying to generate custom applications. And so we are seeing a lot of our customers looking for much more fast deployment, cGPUs, not a lot of customization, total cost of ownership, so against our traditional competitors that's how we usually beat them.

And with SharePoint, as over the past few years as they are now deployed and in large -- in many cases, customers will have 200, 300 instances of SharePoint. How do I now manage those instances and how, now that I use this, what else could I be doing that could be effective? And so we are seeing that SharePoint is becoming quite an additional market for us of expansion. So while you could say it is a competitor, it also has been a good source of additional revenue for us.

Brian Freed - Wunderlich Securities - Analyst

Okay and then my second question, as we look at the initiatives you have on the productivity side with Symantec, Mobility, Social Media and BPM. Can you talk a little bit about either internal or external benchmarks that you guys are driving towards? And what you would point us to as we track your success?

John Shackleton - Open Text - President and CEO

Yes, a couple of things I would say. The AIM study that showed that their productivity within workers using smartphones, et cetera, has a significant increase, 30% plus. We are interestingly seeing military -- so anybody with a highly distributed work forces, military, police, ambulances, et cetera. So in fact the government is doing quite a bit of interest in this area.

And again it is everything from being able to submit your expenses with your receipts from your smartphone by taking photographs of the receipts. Hitting the -- because it's all automated, the turnaround in expense payment, as well as the ability to have much better control over your expenses, is a major -- just an example of an opportunity. But everything from military using smartphones in the battlefield if you will, and communicating back with headquarters, et cetera, is showing tremendous productivity gains. So there is a whole spectrum of applications, smart applications, using this technology.

Brian Freed - Wunderlich Securities - Analyst

Great. As we look at your success in the segment are there any metrics you would point us to that we can use to kind of benchmark your progress in gaining momentum and share in that segment?

John Shackleton - Open Text - President and CEO

Right. We have to look at it, obviously one thing that was touched on earlier. As we start looking at Cloud computing and software as a service. As it gets to a certain point we will try and -- we'll break that out as a separate line item even though it might be in the maintenance line. We will actually show how that is growing once it reaches a certain critical mass. And what we will try and do is give you some color on these productivity versus compliance applications. We'll try and give you a little bit more color on that.

Operator

Derrick Wood, Susquehanna International Group.

Derrick Wood - Susquehanna International Group - Analyst

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A couple questions for you Paul. Could you describe the \$4 million charge again, what that was related to?

Paul McFeeters - Open Text - CFO

Yes, there was a long-term incentive plan in place for a number of senior people in the Company, which is a 3-year plan based on Company performance against peer group and average earnings per share. So we cannot value that against peer group. We cannot amortize that normally through, if you will, the 12 quarters. So there's a little bit of a catch-up in Q3 for that for about \$4 million as I mentioned.

Derrick Wood - Susquehanna International Group - Analyst

And that goes away next quarter?

Paul McFeeters - Open Text - CFO

Yes.

Derrick Wood - Susquehanna International Group - Analyst

Then, you've given this in the past how much the percentage of license revenue from SAP?

Paul McFeeters - Open Text - CFO

It is running consistently around 10%.

Derrick Wood - Susquehanna International Group - Analyst

And could you comment on the foreign currency benefit on revenue and maybe deferred revenue, if you have that?

Paul McFeeters - Open Text - CFO

I wouldn't have any deferred revenues. What we don't do, is we don't breakout the specific line by line item. I said the sequential foreign currency effect was a negative \$0.01. What we do, do Derrick though is we do provide in the press release percentage of revenues and expenses in each of the major currencies.

Derrick Wood - Susquehanna International Group - Analyst

Okay. And then on the weComm, do you have any color on the revenue run rate for that business?

Paul McFeeters - Open Text - CFO

It's minor. Around a couple of million dollars.

John Shackleton - Open Text - President and CEO

Yes, it was around a couple of million dollars. They've been in business for about 10 years doing some very significant R&D around the whole Mobile app framework, but they're really at a point where they were about to start monetizing that with some of the mobile carriers -- even like Turner Broadcasting uses it for their NBC -- you know the basketball organization where you can see all the clips and scores and all that kind of stuff. That is using weComm to deploy that.

Derrick Wood - Susquehanna International Group - Analyst

And that is a couple million dollars annual or quarter?

Paul McFeeters - Open Text - CFO

Annual.

John Shackleton - Open Text - President and CEO

It was annual at this point. Obviously, they didn't have a very large -- in fact they didn't have any sales force really. It is really a technology company, but obviously we think we can capitalize on that.

Derrick Wood - Susquehanna International Group - Analyst

Okay. And lastly, I'm just curious on Metastorm. How much of the revenue's coming from the channel and are you planning on doing anything to change your efforts relative to the direct-indirect mix?

John Shackleton - Open Text - President and CEO

Our intent is to keep the sales force, the Metastorm sales force intact. Both keep them selling into the markets they've been selling into, but also obviously then cross-sell into our large accounts with that. And we certainly want to keep their partner ecosystems as well. I'm not sure, Paul, do you have the mix up number. It's about the same as ours, if I remember, of partners, it might be slightly less, it might be 30% partners, the revenue for them at this point.

Operator

Blair Abernathy, Stifel Nicolaus.

Blair Abernathy - Stifel Nicolaus & Company - Analyst

John just a little more on the indirect channel. I guess I'm looking for some more color on your relationship with SAP at this juncture. Doing \$6 million, \$7 million a quarter is good for you guys. It is a pretty minuscule piece for SAP given their revenue base of \$19 billion, so what I am wondering is how much investment is SAP putting into you guys this year? Relative to the last couple of years and how much opportunity is there in this relationship for Open Text?

John Shackleton - Open Text - President and CEO

They are seeing significant growth on their side. Looking at next year they are looking at quite a jump in growth on our revenues. I would say there's two places. If you look at their kind of major mature audiences of Europe and North America. Even in North America we are seeing significant growth for them but we are also -- I think where the interest for both of us substantially is, is in the emerging markets so places like China or Australia, et cetera, where we are working very closely together in those areas.

We've just won -- we expect to receive a pinnacle award from them this year again. And so -- which is their award to their best partners, so we think they are very happy with the relationship. They are investing a significant amount of money in their go-to-market process for their teams. So I would see it continuing to grow.

Blair Abernathy - Stifel Nicolaus & Company - Analyst

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Do you have a sense John, of how many of their reps are actively selling your products? I'm trying to get a feel for -- you have got 400 reps out there, how much manpower is SAP throwing at this?

John Shackleton - Open Text - President and CEO

Maybe I could answer it this way. When we started, probably 8 years ago when we acquired IXOS. IXOS were in SAP's top 2%. So it was only in the very large client base.

Now just about any public company using SAP needs our products. So it has opened up to much more of their customer base than it ever was before. And seems to be, as looking at even some of these markets like China and Latin America where they are not as large customers or not as large companies, they are looking for this kind of product. So I couldn't quantify how many of their thousands of sales force are selling it, but there seems, it's -- I can maybe get that for you, Blair if that would help.

Blair Abernethy - Stifel Nicolaus & Company - Analyst

Okay. No, that's great, thank you. Just one other question or just switching to the other side, now your direct sales force. Your reps now, you said somewhat above 400, let's call it 400 sales reps, John what are -- can you give us a sense of what the annual targets are for these guys at this point? Is that a mix of inside and outside in that 400 or I'm trying to get a feel for what is the direct relationship quota-carrying guys?

John Shackleton - Open Text - President and CEO

Right. So, in that there is a little bit of inside, a little bit of partner relationships, or partners relationship that have incremental quota and then the kind of core direct salespeople that quota is typically around \$2.5 million or \$3 million, which is a mixture of license, first-year maintenance and a little bit of professional services. So somewhere like \$2 million of licensing, if you will.

Operator

Ralph Garcea, Northland Capital Partners.

Ralph Garcea - Northland Capital Partners Inc. - Analyst

Just some quick questions here. On the productivity side. What is the biggest seller? Are your customers seeing ROI's in the 12-month timeframe? Or shorter or longer?

John Shackleton - Open Text - President and CEO

That is a very good question, Ralph. They're looking for a payback within their budgeted year. So that if they are budgeting the spend this year they are looking for payback within that same budget year.

Ralph Garcea - Northland Capital Partners Inc. - Analyst

And are these pilots easier to implement and test? I would gather they are versus the compliance ones and that's why you're seeing some growth here?

John Shackleton - Open Text - President and CEO

Right, part of it is also if you look at us versus some of the competition, ours is much easier to install, not a lot of customization, et cetera. So it allows them to do that.

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Ralph Garcea - Northland Capital Partners Inc. - Analyst

Okay and on the Mobility and Social Media side. Are you using those apps as loss leaders to sell the full suite or enticed the base to upgrade? What sort of revenue ticket are you putting next to some of these apps?

John Shackleton - Open Text - President and CEO

It depends if they are just using the new user interface that you saw like in the G20, where they are just using that as part of their traditional products, or if they're using a specific application -- a Mobile app like I mentioned, the Expense Management, where you are looking at paying per seat for that kind of access and ability.

So what we would see is, if you are looking at this whole Mobile apps space, we are looking at somewhere between \$5 and \$15 per seat, for depending on what kind of app that is. Certainly not loss, when we talk about pilots that we have done in the Social Media Mobile apps space, half of those are paid pilots.

Ralph Garcea - Northland Capital Partners Inc. - Analyst

And just on the large deals over \$1 million? Was there any concentration either geographically or by vertical?

John Shackleton - Open Text - President and CEO

No, the good point was it was actually Europe, Canada and Asia-PAC and across all -- everything from financial services to government to what you call consumer goods.

Ralph Garcea - Northland Capital Partners Inc. - Analyst

It was really only the two government ones that sort of carried over, so -- and the other 8 were new (inaudible), you were working through the pipeline on.

John Shackleton - Open Text - President and CEO

Yes, that's right.

Operator

Gabriel Leung, Paradigm Capital.

Gabriel Leung - Paradigm Capital - Analyst

I guess when you look back over the past few years, a big part of your focus had been on cost containment, barring the operating margins and whatnot. It sounds like, based on your comments today, that there seems to be a greater willingness to invest more into the business. Now is that, you think a reflection of some of the discussions you're having with your customers on their own appetite to spend on your solutions, number one?

And number two, how quickly do you think you can convert these higher-level investments into a re-acceleration in license growth, recognizing the fact that this quarter was obviously a very good one for license revenues?

John Shackleton - Open Text - President and CEO

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To answer the first one, we still will work within the model that we have always used. So while we talk about R&D spend, it is somewhere in that 14% to 16% model. We don't see going outside of that model. We still -- sales and marketing spend we are still looking in that 23%, 25% model. You won't see us going beyond that.

So while -- if we can see that the -- for example the BPM market is supposed to grow at 20% per se, this coming year, we will be monitoring in that and watching that but it will still be within our overall model that we'll do that. We are not going to do a Google.

Gabriel Leung - Paradigm Capital - Analyst

Okay. And then secondly, you're talking a little bit more about Cloud and the Cloud offerings. As that portion of the business ramps up, how do you think that would affect your revenues and margins? Obviously the revenue recognition there is a little bit more different from your traditional license and maintenance services?

John Shackleton - Open Text - President and CEO

What we are actually seeing is that, as I mentioned earlier, many of our existing customers want both, so that there are instances that they want to keep behind the firewall with all the security with that. With some of the total generics software as a service Cloud, it is often new customers, so it's incremental revenue anyway.

I know what you are trying to get to, and I think what we are trying to do is obviously manage that process, and from what we are seeing of what's happening naturally, we don't think it should have that much of an impact on our total overall revenue. Or margins for that matter.

Operator

We have no further questions at this time, please continue.

John Shackleton - Open Text - President and CEO

Well again, thanks for all your questions everyone. In summary, I would like to mention we obviously had a good license revenue, pipeline remains strong, we are very comfortable with our annual margin and profitability targets, and we're looking forward to next quarter. Thank you.

Operator

Ladies and gentlemen this concludes the conference call for today. Thank you for participating. Please disconnect your lines.

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