OPEN TEXT CORP
Form 10-Q
October 27, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2011.

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 0-27544

OPEN TEXT CORPORATION

(Exact name of registrant as specified in its charter)

CANADA	**98-0154400**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

275 Frank Tompa Drive, Waterloo, Ontario, Canada N2L 0A1

(Address of principal executive offices)

Registrant s telephone number, including area code: (519) 888-7111

(Former name former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if smaller reporting company) Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

At October 20, 2011, there were 57,810,868 outstanding Common Shares of the registrant.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars, except share data)

	September 30, 2011 (Unaudited)	June 30, 2011
ASSETS		
Cash and cash equivalents	$ 119,294	$ 284,140
Accounts receivable trade, net of allowance for doubtful accounts of $6,277 as of September 30, 2011 and $5,424 as of June 30, 2011 (note 3)	143,837	154,568
Income taxes recoverable (note 13)	17,183	18,911
Prepaid expenses and other current assets	34,987	29,678
Deferred tax assets (note 13)	29,405	27,861
Total current assets	344,706	515,158
Capital assets (note 4)	84,590	77,825
Goodwill (note 5)	1,038,571	832,481
Acquired intangible assets (note 6)	414,281	344,995
Deferred tax assets (note 13)	29,401	42,737
Other assets (note 7)	19,408	19,359
Deferred charges (note 8)	61,022	54,989
Long-term income taxes recoverable (note 13)	41,161	44,819
Total assets	$ 2,033,140	$ 1,932,363
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities (note 9)	$ 138,005	$ 126,249
Current portion of long-term debt (note 10)	63,388	15,545
Deferred revenues	249,097	254,531
Income taxes payable (note 13)	19,157	18,424
Deferred tax liabilities (note 13)	1,991	624
Total current liabilities	471,638	415,373
Long-term liabilities:		
Accrued liabilities (note 9)	13,834	13,727
Deferred credits (note 8)	6,538	6,878
Pension liability (note 11)	18,171	18,478
Long-term debt (note 10)	281,285	282,033
Deferred revenues	12,240	11,466
Long-term income taxes payable (note 13)	103,310	101,434
Deferred tax liabilities (note 13)	54,850	43,529
Total long-term liabilities	490,228	477,545
Shareholders equity:		
Share capital (note 12)		
57,790,868 and 57,301,812 Common Shares issued and outstanding at September 30, 2011 and June 30, 2011, respectively; Authorized Common Shares: unlimited	622,337	614,279
Additional paid-in capital	79,454	74,301

Accumulated other comprehensive income	44,102	60,470
Retained earnings	351,880	316,894
Treasury stock, at cost (572,413 shares at September 30, 2011 and June 30, 2011, respectively)	(26,499)	(26,499)
Total shareholders equity	1,071,274	1,039,445
Total liabilities and shareholders equity	$ 2,033,140	$ 1,932,363

Guarantees and contingencies (note 18)

Related party transactions (note 21)

See accompanying Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands of U.S. dollars, except per share data)

(Unaudited)

	Three months ended September 30,	
	2011	**2010**
Revenues:		
License	$ 65,028	$ 42,646
Customer support	161,997	129,757
Service and other	61,021	45,002
Total revenues	288,046	217,405
Cost of revenues:		
License	3,998	3,502
Customer support	26,269	19,356
Service and other	50,351	35,113
Amortization of acquired technology-based intangible assets (note 6)	20,790	15,427
Total cost of revenues	101,408	73,398
Gross profit	186,638	144,007
Operating expenses:		
Research and development	43,458	30,963
Sales and marketing	64,880	44,180
General and administrative	25,761	19,810
Depreciation	5,258	4,875
Amortization of acquired customer-based intangible assets (note 6)	13,041	8,801
Special charges (note 16)	7,105	3,195
Total operating expenses	159,503	111,824
Income from operations	27,135	32,183
Other income, net	9,274	2,480
Interest expense, net	(4,348)	(4,135)
Income before income taxes	32,061	30,528
Provision for (recovery of) income taxes (note 13)	(2,925)	8,857
Net income for the period	$ 34,986	$ 21,671
Net income per share basic (note 20)	$ 0.61	$ 0.38
Net income per share diluted (note 20)	$ 0.60	$ 0.37

Weighted average number of Common Shares outstanding basic	57,412	56,883
Weighted average number of Common Shares outstanding diluted	58,599	57,922

See accompanying Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

(In thousands of U.S. dollars)

(Unaudited)

	Three months ended September 30,	
	2011	**2010**
Retained earnings, beginning of period	$ 316,894	$ 193,691
Net income	34,986	21,671
Retained earnings, end of period	$ 351,880	$ 215,362

See accompanying Notes to Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Three months ended September 30, 2011	2010
Cash flows from operating activities:		
Net income for the period	$ 34,986	$ 21,671
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of intangible assets	39,089	29,103
Share-based compensation expense	4,844	2,600
Excess tax benefits on share-based compensation expense	(332)	(432)
Pension expense	137	123
Amortization of debt issuance costs	330	333
Loss on sale and write down of capital assets	169	
Deferred taxes	(14,849)	(181)
Impairment and other non cash charges	(1,355)	
Changes in operating assets and liabilities:		
Accounts receivable	21,654	27,878
Prepaid expenses and other current assets	5,842	(2,528)
Income taxes	17,696	32,862
Deferred charges and credits	(9,046)	(27,725)
Accounts payable and accrued liabilities	(21,407)	(25,991)
Deferred revenue	(32,998)	(7,234)
Other assets	588	(1,545)
Net cash provided by operating activities	45,348	48,934
Cash flows from investing activities:		
Additions of capital assets-net	(7,902)	(6,943)
Purchase of Operitel Corporation, net of cash acquired	(6,260)	
Purchase of Global 360 Holding Corp., net of cash acquired	(247,711)	
Purchase consideration for prior period acquisitions	(274)	(1,406)
Investments in marketable securities		(668)
Net cash used in investing activities	(262,147)	(9,017)
Cash flow from financing activities:		
Excess tax benefits on share-based compensation expense	332	432
Proceeds from issuance of Common Shares	7,837	3,246
Proceeds from long-term debt	48,500	
Repayment of long-term debt	(916)	(878)
Net cash provided by financing activities	55,753	2,800
Foreign exchange gain (loss) on cash held in foreign currencies	(3,800)	15,783
Increase (decrease) in cash and cash equivalents during the period	(164,846)	58,500
Cash and cash equivalents at beginning of the period	284,140	326,192
Cash and cash equivalents at end of the period	$ 119,294	$ 384,692

Supplementary cash flow disclosures (note 19)

See accompanying Notes to Condensed Consolidated Financial Statements

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UNAUDITED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended September 30, 2011

(Tabular amounts in thousands, except share and per share data)

NOTE 1 BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of Open Text Corporation and our wholly owned subsidiaries, collectively referred to as Open Text or the Company . All inter-company balances and transactions have been eliminated.

These consolidated financial statements are expressed in U.S. dollars and are prepared in accordance with United States generally accepted accounting principles (U.S. GAAP). The information furnished reflects all adjustments necessary for a fair presentation of the results for the periods presented and includes the financial results of Operitel Corporation (Operitel), with effect from September 1, 2011 and Global 360 Holding Corp. (Global 360), with effect from July 13, 2011 (see note 17).

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates, judgments and assumptions that affect the amounts reported in the consolidated financial statements. These estimates, judgments and assumptions are evaluated on an ongoing basis. We base our estimates on historical experience and on various other assumptions that we believe are reasonable at that time, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates. In particular, significant estimates, judgments and assumptions include those related to: (i) revenue recognition, (ii) allowance for doubtful accounts, (iii) testing of goodwill for impairment, (iv) the valuation of acquired intangible assets, (v) the valuation of long-lived assets, (vi) the recognition of contingencies, (vii) restructuring accruals, (viii) acquisition accruals and pre-acquisition contingencies, (ix) asset retirement obligations, (x) the realization of investment tax credits, (xi) the valuation of stock options granted and liabilities related to share-based payments, including the valuation of our long-term incentive plan, (xii) the valuation of financial instruments, (xiii) the valuation of pension assets and obligations, and (xiv) accounting for income taxes.

Comprehensive income

The following table sets forth the components of comprehensive income for the reporting periods indicated:

	Three months ended September 30,	
	2011	**2010**
Net income for the period	$ 34,986	$ 21,671
Other comprehensive income net of tax, where applicable:		
Foreign currency translation adjustments	(10,618)	5,977
Unrealized gain on marketable securities		44
Unrealized gain (loss) on cash flow hedges	(5,202)	1,570
Actuarial gain (loss) relating to defined benefit pension plans	(548)	
Comprehensive income for the period	$ 18,618	$ 29,262

NOTE 2 NEW ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING POLICY UPDATES

Recent Accounting Pronouncements

Comprehensive Income

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income (ASU 2011-05), to

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require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for us in our first quarter of the fiscal year ending June 30, 2013 (Fiscal 2013) and will be applied retrospectively. We are currently evaluating the impact of our pending adoption of ASU 2011-05 on our consolidated financial statements.

Fair Value Measurement and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820) Fair Value Measurement (ASU 2011-04), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements (as defined in note 14 below). ASU 2011-04 is effective for us in our third quarter of the fiscal year ending June 30, 2012 (Fiscal 2012) and we do not believe these provisions will have a material impact on our consolidated financial statements.

Testing Goodwill for Impairment

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles Goodwill and Other (Topic 350) Testing Goodwill for Impairment (ASU 2011-08), to allow entities to use a qualitative approach to test goodwill for impairment. ASU 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. ASU 2011-08 is effective for us in Fiscal 2013 and earlier adoption is permitted. We are currently evaluating the impact of our pending adoption of ASU 2011-08 on our consolidated financial statements. We do not expect the adoption of ASU 2011-08 to materially impact the carrying value of our recorded goodwill.

NOTE 3 ALLOWANCE FOR DOUBTFUL ACCOUNTS

Balance of allowance for doubtful accounts as of June 30, 2011	5,424
Bad debt expense for the period	1,065
Write-off /adjustments	(212)
Balance of allowance for doubtful accounts as of September 30, 2011	$ 6,277

NOTE 4 CAPITAL ASSETS

	As of September 30, 2011		
	Cost**	Accumulated Depreciation**	Net
Furniture and fixtures	$ 9,856	$ 2,888	$ 6,968
Office equipment	1,094	684	410
Computer hardware	49,640	33,700	15,940
Computer software	10,507	4,999	5,508
Leasehold improvements	27,122	10,636	16,486
Buildings*	42,028	2,750	39,278
	$ 140,247	$ 55,657	$ 84,590

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	As of June 30, 2011		
	Cost**	Accumulated Depreciation**	Net
Furniture and fixtures	$ 7,421	$ 2,667	$ 4,754
Office equipment	1,214	657	557
Computer hardware	43,961	30,191	13,770
Computer software	9,668	3,858	5,810
Leasehold improvements	26,483	9,599	16,884
Buildings*	38,648	2,598	36,050
	$ 127,395	$ 49,570	$ 77,825

* As of September 30, 2011, the construction of our new building in Waterloo, Ontario, Canada was completed and was put into use at the beginning of September, 2011. The total cost of this building was $24.0 million and $0.05 million of related accumulated depreciation was recorded during the quarter. (As of June 30, 2011 $20.6 million for the new building was included in the cost).

** Excludes the original cost and accumulated depreciation of fully-depreciated assets, and assets that are no longer in use.

NOTE 5 GOODWILL

Goodwill is recorded when the consideration paid for an acquisition of a business exceeds the fair value of identifiable net tangible and intangible assets. The following table summarizes the changes in goodwill since June 30, 2011:

Balance, June 30, 2011	$ 832,481
Acquisition of Operitel (note 17)	4,093
Acquisition of Global 360 (note 17)	202,572
Adjustments on account of foreign exchange	(575)
Balance, September 30, 2011	$ 1,038,571

NOTE 6 ACQUIRED INTANGIBLE ASSETS

	Technology Assets	Customer Assets	Total
Net book value, June 30, 2011	$ 203,630	$ 141,365	$ 344,995
Acquisition of Operitel (note 17)	2,761	1,840	4,601
Acquisition of Global 360 (note 17)	40,600	58,100	98,700
Amortization expense	(20,790)	(13,041)	(33,831)
Foreign exchange and other impacts	(93)	(91)	(184)
Net book value, September 30, 2011	$ 226,108	$ 188,173	$ 414,281

The weighted average amortization period for acquired technology and customer intangible assets is approximately 5 years and 7 years, respectively.

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The following table shows the estimated future amortization expense for the fiscal years indicated below. This calculation assumes no future adjustments to acquired intangible assets:

	Fiscal years ending June 30,
2012 (nine months ended June 30)	$ 103,810
2013	135,176
2014	76,594
2015	52,808
2016 and beyond	45,893
Total	$ 414,281

NOTE 7 OTHER ASSETS

	As of September 30, 2011	As of June 30, 2011
Debt issuance costs	$ 2,702	$ 3,032
Deposits and restricted cash	10,666	10,379
Long-term prepaid expenses and other long-term assets	6,040	5,948
	$ 19,408	$ 19,359

Debt issuance costs relate primarily to costs incurred for the purpose of obtaining our term loan and are being amortized over the term of the loan (see note 10). Deposits and restricted cash relate to security deposits provided to landlords in accordance with facility lease agreements and cash restricted per the terms of contractual-based agreements. Long-term prepaid expenses and other long-term assets primarily relate to certain advance payments on long-term licenses that are being amortized over the applicable terms of the licenses.

NOTE 8 DEFERRED CHARGES AND CREDITS

Deferred charges and credits relate to cash taxes payable and the elimination of deferred tax balances on account of legal entity consolidations completed as part of an internal reorganization of our international subsidiaries. Deferred charges and credits are amortized to income tax expense over a period of 6 years.

NOTE 9 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Current liabilities

Accounts payable and accrued liabilities are comprised of the following:

	As of September 30, 2011	As of June 30, 2011
Accounts payable trade	$ 12,016	$ 10,772
Accrued salaries and commissions	43,830	45,630
Accrued liabilities	72,215	60,060
Amounts payable in respect of restructuring and other special charges (note 16)	7,656	6,504
Accruals relating to acquisitions	1,018	1,042
Asset retirement obligations	1,270	2,241

	$	138,005	$	126,249

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Long-term accrued liabilities

	As of September 30, 2011	As of June 30, 2011
Amounts payable in respect of restructuring and other special charges (note 16)	$ 526	$ 652
Accruals relating to acquisitions	1,577	2,301
Other accrued liabilities	8,031	6,950
Asset retirement obligations	3,700	3,824
	$ 13,834	$ 13,727

Accruals relating to acquisitions

In relation to our acquisitions made before July 1, 2009, the date on which we adopted Accounting Standards Codification (ASC) Topic 805 Business Combinations (ASC Topic 805), we have accrued for costs relating to abandonment of excess legacy facilities. Such accruals were capitalized as part of the cost of the subject acquisition and have been recorded at present value less our best estimate for future sub-lease income and costs incurred to achieve sub-tenancy. The accrual for excess facilities will be discharged over the term of the respective leases. Any excess of the difference between the present value and actual cash paid for an abandoned facility will be charged to income and any deficits will be reversed to goodwill. The provisions for abandoned facilities are expected to be paid by February 2015. As of September 30, 2011, the remaining balance of our acquisition accruals is $2.6 million (June 30, 2011 $3.3 million).

Asset retirement obligations

We are required to return certain of our leased facilities to their original state at the conclusion of our lease. We have accounted for such obligations in accordance with ASC Topic 410 Asset Retirement and Environmental Obligations (ASC Topic 410). As of September 30, 2011, the present value of this obligation was $5.0 million (June 30, 2011 $6.1 million), with an undiscounted value of $5.5 million (June 30, 2011 $6.5 million).

NOTE 10 LONG-TERM DEBT

Long-term debt

Long-term debt is comprised of the following:

	As of September 30, 2011	As of June 30, 2011
Long-term debt		
Term loan	$ 284,278	$ 285,026
Revolver	48,500	
Mortgage	11,895	12,552
	344,673	297,578
Less:		
Current portion of long-term debt		
Term loan	2,993	2,993
Revolver	48,500	
Mortgage	11,895	12,552
	63,388	15,545
Long-term portion of long-term debt	$ 281,285	$ 282,033

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Term loan

The term loan has a seven-year term, expires on October 2, 2013 and bears interest at a floating rate of LIBOR plus 2.25%. The quarterly scheduled term loan principal repayments are equal to 0.25% of the original principal amount, due each quarter with the remainder due at the end of the term, less ratable reductions for any non-scheduled prepayments made. Our current quarterly scheduled principal payment is approximately $0.7 million.

For the three months ended September 30, 2011, we recorded interest expense of $1.8 million relating to the term loan (three months ended September 30, 2010 $1.9 million).

Revolver

Prior to September 29, 2011, the revolver had a five-year term and expired on October 2, 2011. However, on September 29, 2011, we extended the revolver for 60 days without change to any of the previous terms except that the amount available to borrow under the revolver was changed to $50.0 million from $75.0 million. Borrowings under this facility bear interest at rates specified in the credit agreement. The revolver is subject to a stand-by fee ranging between 0.30% and 0.50% per annum depending on our consolidated leverage ratio.

As of September 30, 2011, we have a net borrowed amount outstanding of $48.5 million on the revolver.

For the three months ended September 30, 2011, we recorded an interest expense of $0.6 million relating to borrowings outstanding on the revolver (three months ended September 30, 2010 nil). During this period we also recorded an expense of $0.06 million on account of stand-by fees relating to the revolver (three months ended September 30, 2010 $0.06 million).

Mortgage

In December 2005, we entered into a five-year mortgage agreement with the bank. The principal amount of the mortgage was for Canadian $15.0 million and was originally scheduled to mature on January 1, 2011. During Fiscal 2011, the mortgage was extended for a total of twelve-months, now maturing on January 1, 2012. The principal amount of the mortgage did not change upon extension, however, interest now accrues monthly at a variable rate of Canadian prime plus 0.50% (instead of a fixed rate of 5.25% per annum). Principal and interest are payable in monthly installments of Canadian $0.1 million with a final lump sum principal payment of Canadian $11.9 million due on maturity. The mortgage continues to be secured by a lien on our headquarters in Waterloo, Ontario, Canada.

As of September 30, 2011, the carrying value of the mortgage was $11.9 million (June 30, 2011 $12.6 million).

As of September 30, 2011, the carrying value of the Waterloo building that is securing the mortgage was $15.3 million (June 30, 2011 $15.4 million).

For the three months ended September 30, 2011, we recorded interest expense of $0.1 million relating to the mortgage (three months ended September 30, 2010 $0.2 million).

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NOTE 11 PENSION PLANS AND OTHER POST RETIREMENT BENEFITS

The following table provides details of our defined benefit pension plans and long-term employee benefit obligations for Open Text Document Technologies GmbH (CDT) and IXOS AG (IXOS) as of September 30, 2011 and June 30, 2011:

	Total benefit obligation	Current portion of benefit obligation*	Noncurrent portion of benefit obligation
CDT defined benefit plan	$ 18,045	$ 484	$ 17,561
CDT Anniversary plan	492	78	414
CDT early retirement plan	182		182
IXOS defined benefit plan	14		14
Total as of September 30, 2011	$ 18,733	$ 562	$ 18,171

	Total benefit obligation	Current portion of benefit obligation*	Noncurrent portion of benefit obligation
CDT defined benefit plan	$ 18,231	$ 489	$ 17,742
CDT Anniversary plan	550	57	493
CDT early retirement plan	234		234
IXOS defined benefit plan			