Forestar Group Inc.
Form 10-K
March 02, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2010

or

o **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: 001-33662
Forestar Group Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**26-1336998**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*

6300 Bee Cave Road
Building Two, Suite 500
Austin, Texas 78746-5149
(Address of Principal Executive Offices, including Zip Code)

Registrant s telephone number, including area code: (512) 433-5200

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, par value $1.00 per share	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No þ

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 þ No o

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 o **No** o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing sales price of the Common Stock on the New York Stock Exchange on June 30, 2010, was approximately $544 million. For purposes of this computation, all officers, directors, and ten percent beneficial owners of the registrant (as indicated in Item 12) are deemed to be affiliates. Such determination should not be deemed an admission that such directors, officers, or ten percent beneficial owners are, in fact, affiliates of the registrant.

As of February 25, 2011, there were 35,420,348 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Selected portions of the Company s definitive proxy statement for the 2011 annual meeting of stockholders are incorporated by reference into Part III of this Form 10-K.

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PART I

Item 1. *Business.*

Overview

Forestar Group Inc. is a real estate and natural resources company. We own directly or through ventures over 220,000 acres of real estate located in nine states and 12 markets and about 606,000 net acres of mineral interests. We have over 197,000 acres of timber on our real estate and about 18,000 acres of timber under lease. In 2010, we generated revenues of $101 million and net income of $5 million. Unless the context otherwise requires, references to we, us, our and Forestar mean Forestar Group Inc. and its consolidated subsidiaries. Unless otherwise indicated, information is presented as of December 31, 2010, and references to acreage owned include all acres owned by ventures regardless of our ownership interest in a venture.

We manage our operations through three business segments:

- Real estate,
- Mineral resources, and
- Fiber resources.

A summary of business segment assets at year-end 2010 follows:

Our real estate segment provided 67 percent of our 2010 consolidated revenues. We secure entitlements and develop infrastructure, primarily for single-family residential and mixed-use communities. We own about 167,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We invest in projects principally in our strategic growth corridors, regions across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment.

We have 18 real estate projects representing about 30,000 acres in the entitlement process, principally in Georgia. We also have 76 entitled, developed or under development projects in seven states and 11 markets encompassing over 16,000 remaining acres, comprised of land planned for over 27,000 residential lots and about 2,400 commercial acres, principally in the major markets of Texas. We own and manage projects both directly and through ventures. We sell land at any point within the value chain when additional time required for entitlement or investment in development will not meet our return criteria. In 2010, we sold over

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5,800 acres of undeveloped land through our retail land sales program at an average price of about $3,500 per acre.

Our mineral resources segment provided 25 percent of our 2010 consolidated revenues. We promote the exploitation, exploration and development of oil and gas on our 606,000 net mineral acres. The four principal areas of ownership are Texas, Louisiana, Alabama and Georgia. The majority of our revenues are from oil and gas royalties from over 490 producing wells owned and operated by third parties in Texas and Louisiana and lease bonus payments. Historically, these operations require low capital investment and are low risk.

Our fiber resources segment provided 8 percent of our 2010 consolidated revenues. We sell wood fiber from our land, primarily in Georgia, and lease land for recreational uses. We have about 197,000 acres of timber on our land and about 18,000 acres of timber under lease.

Our real estate origins date back to the 1955 incorporation of Lumbermen s Investment Corporation, which in 2006 changed its name to Forestar (USA) Real Estate Group Inc. We have a decades-long legacy of residential and commercial real estate development operations, primarily in Texas. Our mineral resources origins date back to the mid-1940s when we started leasing our oil and gas mineral interests to third-party exploration and production companies. In 2006, Temple-Inland Inc. began reporting Forestar Real Estate Group as a separate business segment. On December 28, 2007, Temple-Inland distributed all of the issued and outstanding shares of our common stock to its stockholders, which we will refer to in this Annual Report on Form 10-K as the spin-off .

Leveraging over 300 years of real estate, oil and gas, and other natural resources experience, we believe our management team brings extensive knowledge and expertise which better positions us to recognize and responsibly deliver the greatest value from every acre.

Strategy

Our strategy is:

- Recognizing and responsibly delivering the greatest value from every acre; and
- Growing through strategic and disciplined investments.

We are focused on delivering the greatest value from every acre through the entitlement and development of strategically-located residential and mixed-use communities. We secure entitlements by delivering thoughtful plans and balanced solutions that meet the needs of the communities where we operate. Moving land through the entitlement and development process creates significant real estate value. Residential development activities target lot sales to national and regional home builders who build quality products and have strong and effective marketing and sales programs. The lots we deliver in the majority of our communities are for mid-priced homes, predominantly in the first and second move-up categories. We also actively market and sell undeveloped land through our retail sales program. We may develop multifamily commercial tracts ourselves or for other commercial tracts we may either sell to or venture with developers that specialize in the construction and operation of income producing properties.

We seek to maximize value from our oil and gas mineral interests by increasing the acreage leased, lease rates, royalty interests and additional participation in production in the form of non-operating working interests. We realize value from our undeveloped land by selling fiber and by managing it for future real estate development and conservation uses. We also generate cash flow and create additional value through recreational leases.

We are committed to disciplined investment in our business. Approximately 65 of our real estate projects were acquired in the open market, with the remainder coming from the entitlement efforts associated with our low basis

lands principally located in and around Atlanta, Georgia. In 2010, we acquired a 401 unit, Class A multifamily property in Houston, Texas for $49,100,000.

Our portfolio of assets in combination with our strategy, management expertise, stewardship and reinvestment in our business, position Forestar to maximize and grow long-term value for shareholders.

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Strategic Initiatives

In 2009, we announced our near-term strategic initiatives to enhance shareholder value by: generating significant cash flow, principally from the sale of about 175,000 acres of higher and better use timberland; reducing debt by approximately $150 million; and repurchasing up to 20 percent of our common stock.

In 2009, we sold about 95,000 acres of timber and timberland in Georgia and Alabama for approximately $159 million in two transactions generating combined net proceeds of $154 million, which were principally used to reduce debt and pay taxes. These transactions resulted in a combined gain on sale of assets of $104 million.

In 2010, we sold about 24,000 acres of timber and timberland in Georgia, Alabama and Texas for $39 million in seven transactions generating combined net proceeds of $38 million, which were principally used to reinvest in qualifying real estate under Internal Revenue Code (IRC) Section 1031. These transactions resulted in a combined gain on sale of assets of $29 million. In addition, in third quarter 2010, we repurchased 1,000,987 shares of our common stock at a cost of $15 million.

At year-end 2010, assets held for sale under these strategic initiatives includes about 55,000 acres of undeveloped land with a carrying value of $14 million and related timber with a carrying value of $7 million. Though we continue to actively market this land, market conditions for timberland have deteriorated since second quarter 2009 due to increased investor return requirements, limited availability of financing and alternate investment options for buyers in the marketplace. We are a disciplined seller, and as a result, additional time will be required to complete the sale of these assets.

2010 Highlights

In addition to the strategic initiative land sales described above, highlights during 2010 include:

- Opening of the JW Marriott® San Antonio Hill Country Resort & Spa at Cibolo Canyons, entitling us to receive revenues related to hotel occupancy and sales taxes through 2034 from the 1,002 room hotel and golf resort;
- Leasing over 16,900 net mineral acres to oil and natural gas companies for exploration and production activities;
- Entitling two projects which include over 1,000 acres, representing over 2,500 planned residential lots and 75 commercial acres;
- Acquiring a multifamily project in Houston, Texas with tax deferred IRC Section 1031 timberland sales proceeds and non-recourse borrowings;
- Repurchasing over one million shares of our common stock; and
- Acquiring a water resources company focused on providing sustainable volumes of ground water to central Texas and the Interstate-35 growth corridor.

Real Estate

In our real estate segment, we conduct a wide array of project planning and management activities related to the acquisition, entitlement, development and sale of real estate, primarily residential and mixed-use communities. We

own and manage our projects either directly or through ventures, which we use to achieve a variety of business objectives, including more effective capital deployment, risk management, and leveraging a partner s local market contacts and expertise.

We have real estate in nine states and 12 markets encompassing over 220,000 acres, including about 167,000 acres located in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. Our development projects are principally located in the major markets of Texas.

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Our strategy for creating value in our real estate segment is to move acres up the value chain by moving land located in growth corridors but not yet entitled, through the entitlement process, and into development. The chart below depicts our real estate value chain:

We have over 174,000 undeveloped acres located in the path of population growth. As markets grow and mature, we intend to secure the necessary entitlements, the timing for which varies depending upon the size, location, use and complexity of a project. We have almost 30,000 acres in the entitlement process, which includes obtaining zoning and access to water, sewer and roads. Additional entitlements, such as flexible land use provisions, annexation, and the creation of local financing districts generate additional value for our business and may provide us the right to reimbursement of major infrastructure costs. We have over 16,000 acres entitled, developed and under development, comprised of land planned for over 27,000 residential lots and about 2,400 commercial acres. We use return criteria, which include return on cost, internal rate of return, and cash multiple, when determining whether to invest initially or make additional investment in a project. When investment in development meets our return criteria, we will initiate the development process with subsequent sale of lots to homebuilders or, for commercial tracts, internal development, sale to or venture with commercial developers. We sell land at any point within the value chain when additional time required for entitlement or investment in development will not meet our return criteria. In 2010, we sold over 5,800 acres of undeveloped land through our retail land sales program at an average price of about $3,500 per acre.

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A summary of our real estate projects in the entitlement process [a] at year-end 2010 follows:

Project	County	Market	Project Acres[b]
California			
Hidden Creek Estates	Los Angeles	Los Angeles	700
Terrace at Hidden Hills	Los Angeles	Los Angeles	30
Georgia			
Ball Ground	Cherokee	Atlanta	500
Burt Creek	Dawson	Atlanta	970
Crossing	Coweta	Atlanta	230
Dallas Highway	Haralson	Atlanta	1,060
Fincher Road	Cherokee	Atlanta	3,890
Fox Hall	Coweta	Atlanta	960
Garland Mountain	Cherokee/Bartow	Atlanta	350
Home Place	Coweta	Atlanta	1,510
Martin s Bridge	Banks	Atlanta	970
Mill Creek	Coweta	Atlanta	770
Serenity	Carroll	Atlanta	440
Waleska	Cherokee	Atlanta	150
Wolf Creek	Carroll/Douglas	Atlanta	12,230
Yellow Creek	Cherokee	Atlanta	1,060
Texas			
Lake Houston	Harris/Liberty	Houston	3,700
San Jacinto	Montgomery	Houston	150
Total			29,670

[a] A project is deemed to be in the entitlement process when customary steps necessary for the preparation of an application for governmental land-use approvals, like conducting pre-application meetings or similar discussions with governmental officials, have commenced, or an application has been filed. Projects listed may have significant steps remaining, and there is no assurance that entitlements ultimately will be received.

[b] Project acres, which are the total for the project regardless of our ownership interest, are approximate. The actual number of acres entitled may vary.

Products

The majority of our projects are single-family residential and mixed-use communities. In some cases, commercial land uses within a project enhance the desirability of the community by providing convenient locations for resident support services. We sometimes undertake projects consisting exclusively of commercial tracts and, on occasion, we invest in a venture to develop a single commercial project.

We develop lots for single-family homes and may develop multifamily properties on our commercial tracts. In addition, we sell commercial tracts that are substantially ready for construction of buildings for retail, office, industrial

or other commercial uses. We sell residential lots primarily to national and regional homebuilders and, to a lesser extent, local homebuilders. We have 76 entitled, developed or under development projects in seven states and 11 markets, principally in the major markets of Texas, encompassing over 16,000 remaining acres, comprised of land planned for over 27,000 residential lots and about 2,400 commercial acres. We focus our lot sales on the first and second move-up primary housing categories. First and second move-up segments are homes priced above entry-level products yet below the high-end and custom home segments. We reduced investment in real estate development in 2010 as we focused development on

markets and products which continued to generate sales. We also actively market and sell undeveloped land through our retail sales program.

Commercial tracts are developed internally or sold to or ventured with commercial developers that specialize in the construction and operation of income producing properties, such as apartments, retail centers, or office buildings. We sell land designated for commercial use to national retailers and to regional and local commercial developers. We have about 2,400 acres of entitled land designated for commercial use.

One of our current significant mixed-use projects is Cibolo Canyons in the San Antonio market area. Cibolo Canyons is a 2,100 acre mixed-use development planned to include approximately 1,400 residential lots, of which 640 have been sold as of year-end 2010 at an average price of $65,000 per lot. The residential component is planned to include not only traditional single-family homes but also an active adult section and condominiums. Our commercial component is planned to include about 220 acres designated for multifamily and retail uses, of which 64 acres have been sold as of year-end 2010. Located at Cibolo Canyons is the JW Marriott® San Antonio Hill Country Resort & Spa, a 1,002 room destination resort and two PGA Tour® Tournament Players Club® (TPC) golf courses designed by Pete Dye and Greg Norman. The resort hotel began operations on January 22, 2010. We have the right to receive from a legislatively created special purpose improvement district (SPID) 9 percent of hotel occupancy revenues and 1.5 percent of other resort sales revenues collected as taxes by the SPID through 2034 and to reimbursement of certain infrastructure costs related to the mixed-use development.

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A summary of activity within our projects in the development process, which includes entitled [a], developed and under development real estate projects, at year-end 2010 follows:

Project	County	Market	Interest Owned[b]	Residential Lots[c] Lots Sold Since Inception	Residential Lots[c] Lots Remaining	Commercial Acres[d] Acres Sold Since Inception	Commercial Acres[d] Acres Remaining
Projects we own							
California							
San Joaquin River	Contra Costa/Sacramento	Oakland	100%				288
Colorado							
Buffalo Highlands	Weld	Denver	100%		164		
Johnstown Farms	Weld	Denver	100%	115	494	2	8
Pinery West	Douglas	Denver	100%				115
Stonebraker	Weld	Denver	100%		603		13
Westlake Highlands	Jefferson	Denver	100%	21			
Texas							
Arrowhead Ranch	Hays	Austin	100%		259		6
Caruth Lakes	Rockwall	Dallas/Fort Worth	100%	310	339		
Cibolo Canyons	Bexar	San Antonio	100%	640	775	64	157
Harbor Lakes	Hood	Dallas/Fort Worth	100%	201	248	2	12
Hunter s Crossing	Bastrop	Austin	100%	340	150	38	71
La Conterra	Williamson	Austin	100%	76	424		58
Maxwell Creek	Collin	Dallas/Fort Worth	100%	700	299	10	
Oak Creek Estates	Comal	San Antonio	100%	69	578	13	
The Colony	Bastrop	Austin	100%	412	734	22	31
The Gables at North Hill	Collin	Dallas/Fort Worth	100%	199	84		
The Preserve at Pecan Creek	Denton	Dallas/Fort Worth	100%	306	512		9
The Ridge at Ribelin Ranch	Travis	Austin	100%			179	16
Westside at Buttercup Creek	Williamson	Austin	100%	1,318	196	66	
Other projects (9)	Various	Various	100%	1,554	18	197	24
Georgia							
Towne West	Bartow	Atlanta	100%		2,674		121
Other projects (13)	Various	Atlanta	100%		2,934		705
Missouri and Utah							
Other projects (2)	Various	Various	100%	458	96		
				6,719	**11,581**	**593**	**1,634**

Projects in entities we consolidate
Texas

City Park	Harris	Houston	75%	1,134	177	50	115
Lantana	Denton	Dallas/Fort Worth	55%(e)	593	1,639		
Light Farms	Collin	Dallas/Fort Worth	65%		2,868		
Stoney Creek	Dallas	Dallas/Fort Worth	90%	107	647		
Timber Creek	Collin	Dallas/Fort Worth	88%		614		
Other projects (5)	Various	Various	Various	953	254	26	25
				2,787	**6,199**	**76**	**140**
Total owned and consolidated				**9,506**	**17,780**	**669**	**1,774**
Projects in ventures that we account for using the equity method							
Georgia							
Seven Hills	Paulding	Atlanta	50%	636	445	26	113
The Georgian	Paulding	Atlanta	38%	288	1,097		
Other projects (4)	Various	Atlanta	Various	1,820	77	3	
Texas							
Bar C Ranch	Tarrant	Dallas/Fort Worth	50%	232	967		
Entrada	Travis	Austin	50%		821		3
Fannin Farms West	Tarrant	Dallas/Fort Worth	50%	309	72		15
Harper s Preserve	Montgomery	Houston	50%		1,722		72
Lantana	Denton	Dallas/Fort Worth	Various(e)	1,436	116	14	76
Long Meadow Farms	Fort Bend	Houston	19%	693	1,390	87	133
Southern Trails	Brazoria	Houston	40%	452	575		
Stonewall Estates	Bexar	San Antonio	25%	261	121		
Summer Creek Ranch	Tarrant	Dallas/Fort Worth	50%	796	478		71
Summer Lakes	Fort Bend	Houston	50%	345	778	56	
Village Park	Collin	Dallas/Fort Worth	50%	356	211	3	2
Waterford Park	Fort Bend	Houston	50%		210		90
Other projects (2)	Various	Various	Various	296	228		15
Florida							
Other projects (3)	Various	Tampa	Various	519	326		
Total in ventures				**8,439**	**9,634**	**189**	**590**
Combined total				**17,945**	**27,414**	**858**	**2,364**

[a] A project is deemed entitled when all major discretionary governmental land-use approvals have been received. Some projects may require additional permits and/or non-governmental authorizations for development.

[b] Interest owned reflects our net equity interest in the project, whether owned directly or indirectly. There are some projects that have multiple ownership structures within them. Accordingly, portions of these projects may appear as owned, consolidated or accounted for using the equity method.

[c] Lots are for the total project, regardless of our ownership interest. Lots remaining represent vacant developed lots, lots under development and future planned lots and are subject to change based on business plan revisions.

[d] Commercial acres are for the total project, regardless of our ownership interest, and are net developable acres, which may be fewer than the gross acres available in the project.

[e] The Lantana project consists of a series of 18 partnerships in which our voting interests range from 25 percent to 55 percent. We account for three of these partnerships using the equity method and we consolidate the remaining partnerships.

A summary of our significant commercial and income producing properties at year-end 2010 follows:

Project	County	Market	Interest Owned[a]	Type	Description
Broadstone Memorial	Harris	Houston	100%	Multifamily	401 unit luxury apartment
Radisson Hotel	Travis	Austin	100%	Hotel	413 guest rooms and suites
Palisades West	Travis	Austin	25%	Office	375,000 square feet
Las Brisas	Williamson	Austin	59%	Multifamily	414 unit luxury apartment

[a] Interest owned reflects our net equity interest in the project, whether owned directly or indirectly.

Markets

Current U.S. market conditions in the single-family residential industry continue to be difficult, characterized by depressed sales volumes and prices, increased foreclosures, high unemployment rates and low consumer confidence. While all markets are being negatively affected by overall poor economic conditions, not all geographic areas and products have been affected to the same extent or with equal severity. These difficult market conditions may continue throughout 2011.

We target investments primarily in markets within our strategic growth corridors, which we define as areas possessing favorable growth characteristics for population, employment and household formation. These markets are generally located across the southern half of the U.S., and we believe they represent attractive long-term real estate investment opportunities. Demand for residential lots, single-family housing, and commercial land is substantially influenced by these growth characteristics, as well as by immigration and in-migration. Currently, most of our development projects are located within the major markets of Texas.

Our ten strategic growth corridors encompass 165,000 square miles, or approximately 5 percent of the total land area in the U.S. According to 2005 census data, 85 million people, 29 percent of the U.S. total, reside in these corridors. The population density in these growth corridors is almost seven times the national average and is projected to grow at nine times the national average between 2000 and 2030. During that time, the corridors are projected to garner approximately 43 percent of the nation s population growth and 38 percent of total employment growth. Estimated housing demand from these ten growth corridors from 2000 to 2030 exceeds 23 million new homes.

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Forestar Strategic Growth Corridors

Our strategy includes not only entitlement and development on our own lands but also growth through strategic and disciplined investment in acquisitions that meet our investment criteria. We continually monitor the markets in our strategic growth corridors for opportunities to purchase developed lots and land at prices that meet our return criteria.

Competition

We face competition for the acquisition, entitlement, development and sale of real estate in our markets. Our major competitors include other landowners who market and sell undeveloped land and numerous national, regional and local developers. In addition, our projects compete with other development projects offering similar amenities, products and/or locations. Competition also exists for investment opportunities, financing, available land, raw materials and labor, with entities that may possess greater financial, marketing and other resources than us. The presence of competition may increase the bargaining power of property owners seeking to sell. These competitive market pressures sometimes make it difficult to acquire, entitle, develop or sell land at prices that meet our return criteria. Some of our real estate competitors are well established and financially strong, may have greater financial resources than we do, or may be larger than us and/or have lower cost of capital and operating costs than we have and expect to have.

The land acquisition and development business is highly fragmented, and we are unaware of any meaningful concentration of market share by any one competitor. Enterprises of varying sizes, from individuals or small companies to large corporations, actively engage in the real estate development business. Many competitors are local, privately-owned companies. We have a few regional competitors and virtually no national competitors other than national homebuilders that, depending on business cycles and market

conditions, may enter or exit the real estate development business in some locations to develop lots on which they construct and sell homes. There are very few national homebuilders currently developing lots. During periods when access to capital is restricted, participants with weaker financial conditions tend to be less active. We believe the current environment is one where participants with stronger financial conditions will have a competitive advantage and where fewer participants will be active.

Mineral Resources

We lease our mineral interests to third parties for the exploration and production of oil and gas, principally in Texas and Louisiana. When we lease our mineral interests, we may negotiate a lease bonus payment and retain a royalty interest and may take an additional participation in production, including a non-operating working interest. Non-operating working interests refer to well interests in which we pay a share of the costs to drill, complete and operate a well and receive a proportionate share of the production revenues. We are not an operator with respect to any of the oil and gas activities on our properties.

Our royalty revenues are contractually defined and based on a percentage of production and are received in cash. Our royalty revenues fluctuate based on changes in the market prices for oil and gas, the inevitable decline in production in existing wells, and other factors affecting the third-party oil and gas exploration and production companies including the cost of development and production.

Products

We own mineral interests on approximately 606,000 net acres principally in Texas, Louisiana, Georgia and Alabama. All our oil and gas mineral interests are located in the United States. Our minerals revenue is primarily from lease bonus payments, delay rentals, oil and gas royalty interests, non-operating working interests and other related activities. We engage in leasing certain portions of these oil and gas mineral interests to third parties for the exploration and production of oil and gas, and we are increasingly leveraging our mineral interests to participate in wells drilled on or near our mineral acreage.

Our strategy for maximizing value from our mineral interests is to move acres up the minerals value chain by increasing the net acreage leased, the lease bonus amount per acre and the size of retained royalty interests. Additionally, we may participate in non-operating working interests in the drilling, completion and production of oil and gas on or nearby our mineral interests. The chart below depicts our minerals value chain.

Of our 606,000 net acres of mineral interests, about 488,000 net acres are available for lease. We have about 118,000 net acres leased for exploration activities, of which about 30,000 net acres are held by production from over 490 oil and gas wells that are owned and operated by others.

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Our principal areas of ownership follow:

East Texas and Gulf Coast Basins

We have about 251,000 net mineral acres in East Texas and about 144,000 net mineral acres in Louisiana located within the East Texas and Gulf Coast Basins. These basins contain numerous oil and gas producing formations consisting of conventional, unconventional, and tight sand reservoirs. Of these reservoirs, we have mineral interests in and around production trends in the Wilcox, Frio, Cockfield, James Lime, Pettet, Travis Peak, Cotton Valley, Austin Chalk, Haynesville Shale, and Bossier formations.

Fort Worth Basin

We have about 1,000 net mineral acres in the Fort Worth Basin. This basin contains numerous oil and gas producing formations consisting of conventional, unconventional, and tight sand reservoirs. Of these reservoirs, we have mineral interests in and around the Barnett Shale.

Alabama & Georgia

We have about 40,000 net mineral acres in Alabama and about 168,000 net mineral acres in Georgia. These areas have historically had very little oil and gas exploration activity, although since 2006 there has been activity in the Floyd and Conesuega Shales in and around our mineral interests.

A summary of our mineral acres [a] at year-end 2010 follows:

State	Unleased	Leased[b]	Held By Production[c]	Total[d]
		(Net acres)		
Texas	157,000	70,000	25,000	252,000
Louisiana	121,000	18,000	5,000	144,000
Georgia	168,000			168,000
Alabama	40,000			40,000
California	1,000			1,000
Indiana	1,000			1,000
	488,000	88,000	30,000	606,000

(a) Includes ventures.

(b) Includes leases in primary lease term or for which a delayed rental payment has been received.

(c) Acres being held by production are producing oil or natural gas in paying quantities.

(d) Texas, Louisiana, California and Indiana net acres are calculated as the gross number of surface acres multiplied by our percentage ownership of the mineral interest. Alabama and Georgia net acres are calculated as the gross number of surface acres multiplied by our estimated percentage ownership of the mineral interest based on

county sampling. Excludes 463 net mineral acres located in Colorado including 382 acres leased and 26 acres held by production.

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A summary of our Texas and Louisiana mineral acres [a] by county or parish at year-end 2010 follows:

Texas		Louisiana[b]	
County	Net Acres	Parish	Net Acres
Trinity	46,000	Beauregard	79,000
Angelina	42,000	Vernon	39,000
Houston	29,000	Calcasieu	17,000
Anderson	25,000	Allen	7,000
Cherokee	24,000	Rapides	1,000
Sabine	23,000	Other	1,000
Red River	14,000		144,000
Newton	13,000		
San Augustine	13,000		
Jasper	12,000		
Other	11,000		
	252,000		

(a) Includes ventures.

(b) A significant portion of our Louisiana net mineral acres were severed from the surface estate shortly before our spin-off. Under Louisiana law, portions of our net mineral acres that are not producing minerals upon the tenth anniversary of severance from the surface estate will revert back to the surface estate owner.

Leasing mineral acres for exploration and production creates significant value because we may negotiate a lease bonus payment and retain a royalty interest in all revenues generated by the lessee from oil and gas production. The significant terms of these arrangements include granting the exploration company the rights to oil or gas it may find and requiring that drilling be commenced within a specified period. In return, we may receive an initial payment (bonus), subsequent payments if drilling has not started within the specified period (delay rentals), and a percentage interest in the value of any oil or gas produced (royalties). If no oil or gas is produced during the required period, all rights are returned to us. Our capital requirements are minimal and primarily consist of acquisition costs allocated to mineral interests and administrative costs.

Most leases are for a three-year term although a portion or all of a lease may be extended by the lessee as long as actual production is occurring. Financial terms vary based on a number of market factors including the location of the mineral interest, the number of acres subject to the agreement, our mineral interest, proximity to transportation facilities such as pipelines, depth of formations to be drilled and risk. From our retained royalty interests in production sold by third-party exploration and production companies, we received an average net price per barrel of oil of $73.09 in 2010, $56.85 in 2009 and $106.66 in 2008 and per thousand cubic feet of gas of $4.26 in 2010, $4.10 in 2009 and $8.76 in 2008.

We have water interests in about 1.6 million acres which includes a 45 percent nonparticipating royalty interest in groundwater produced or withdrawn for commercial purposes or sold from approximately 1.4 million acres in Texas, Louisiana, Georgia and Alabama, and about 17,800 acres of ground water leases in central Texas acquired in 2010. We have not received significant income from these interests.

Proved Developed Reserves

In December 2009, we adopted revised oil and gas reserve estimation and disclosure requirements to conform to the U.S. Securities and Exchange Commission (SEC) Modernization of Oil and Gas Reporting rules, which were issued in December 2008. The rules require disclosure of proved reserves using the twelve-month average beginning-of-month price for the year, rather than year-end prices. These same twelve month average prices are also used in calculating the amount of (and changes in) future net cash inflows related to the standardized measure of discounted future net cash flows.

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Our net proved developed oil and natural gas reserves as of year-end 2010, 2009 and 2008, all of which are located in the United States, have been estimated by Netherland, Sewell & Associates, Inc. (NSAI) in accordance with the definitions and guidelines of the SEC. This reserve information does not include estimates of reserves and future cash flows associated with proved undeveloped reserves or any potential value related to our over 576,000 undeveloped net mineral acres because we are solely royalty and non-operating working interest owners and as a result we do not determine whether or when undeveloped reserves will be converted to developed reserves. The third-party operators to which we lease our mineral interests do not provide us with their adopted development plans related to our royalty interests.

Net quantities of proved developed oil and natural gas reserves, principally located in the East Texas, Gulf Coast and Fort Worth Basins, related to our royalty and non-operating working interests follows:

	Net Reserves	
	Oil (Barrels)	**Natural Gas (Mcf)**
	(In thousands)	
Consolidated entities:		
Year-end 2010	609	6,659
Year-end 2009	580	6,660
Year-end 2008	457	7,538
Our share of ventures accounted for using the equity method:		
Year-end 2010		3,871
Year-end 2009		2,508
Year-end 2008		125
Total consolidated and our share of equity method ventures:		
Year-end 2010	609	10,530
Year-end 2009	580	9,168
Year-end 2008	457	7,663

We do not have any estimated reserves of synthetic oil, synthetic natural gas or products of other non-renewable natural resources that are intended to be upgraded into synthetic oil and gas.

Reserve estimates were based on the economic and operating conditions existing at year-end 2010, 2009 and 2008. For 2010 and 2009, oil prices are based on a twelve month average price of $75.96 and $57.65 per barrel of West Texas Intermediate Crude and natural gas prices are based on a twelve month average price of $4.38 and $3.87 per MMBTU per the Henry Hub spot market. For 2008, oil prices are based on a year-end 2008, West Texas Intermediate posted price of $41.00 per barrel and natural gas prices are based on a year-end 2008, Henry Hub spot market price of $5.71 per MMBTU. All prices were adjusted for quality, transportation fees and regional price differentials. Since the determination and valuation of proved developed reserves is a function of the interpretation of engineering and geologic data and prices for oil and natural gas and the cost to produce these reserves, the reserves presented should be expected to change as future information becomes available. For an estimate of the standardized measure of discounted future net cash flows from proved developed oil and natural gas reserves, see Note 22 Supplemental Oil and Gas Disclosures (Unaudited) to our consolidated financial statements included in this Annual Report on Form 10-K.

The process of estimating oil and natural gas reserves is complex involving decisions and assumptions in evaluating the available geological, geophysical, engineering and economic data. Accordingly, these estimates are imprecise.

Actual future production, oil and natural gas prices, revenues, taxes and quantities of recoverable oil and natural gas reserves might vary from those estimated. Any variance could materially affect the estimated quantities and present value of proved developed reserves. In addition, we may adjust estimates of proved developed reserves to reflect production history, development, prevailing oil and natural gas prices and other factors, many of which are beyond our control.

The primary internal technical person in charge of overseeing our reserves estimates has a Bachelor of Science in Petroleum Engineering and a Masters of Business Administration in Finance and Accounting. He has over 30 years of experience in the exploration and production business as well as experience in gas processing, refining and marketing, coal, geothermal, manufactured utilities and electricity generation.

As part of our internal control over financial reporting, we have a process for reviewing well production data and division of interest percentages prior to submitting well level data to NSAI to prepare reserve estimates on our behalf. Prior to inclusion in the Annual Report on Form 10-K, our primary internal technical person and other members of management review the reserve estimates prepared by NSAI, including the underlying assumptions and estimates upon which they are based, for accuracy and reasonableness.

Production

Oil and natural gas produced and average unit prices related to our royalty and non-operating working interests follows:

		For the Year	
	2010	**2009**	**2008**
Consolidated entities:			
Oil production (barrels)	115,400	107,200	87,900
Average price per barrel	$ 73.09	$ 56.85	$ 106.66
Natural gas production (millions of cubic feet)	1,223.6	1,411.6	1,363.4
Average price per thousand cubic feet	$ 4.32	$ 4.12	$ 8.76
Our share of ventures accounted for using the equity method:			
Natural gas production (millions of cubic feet)	572.8	82.1	
Average price per thousand cubic feet	$ 4.12	$ 3.80	$
Total consolidated and our share of equity method ventures:			
Oil production (barrels)	115,400	107,200	87,900
Average price per barrel	$ 73.09	$ 56.85	$ 106.66
Natural gas production (millions of cubic feet)	1,796.4	1,493.7	1,363.4
Average price per thousand cubic feet	$ 4.26	$ 4.10	$ 8.76

At year-end 2010, production lifting costs, which exclude ad valorem and severance taxes, were $1.29 per Mcfe (thousand cubic feet equivalent) related to six wells in which we have a non-operating working interest. At year-end 2009, production lifting costs were $1.14 per Mcfe related to six wells in which we have a non-operating working interest. In 2008, this information was not available to us.

Drilling and Other Exploratory and Development Activities; Present Activities

We did not drill any wells or conduct any other exploratory or development activities in 2010, 2009 or 2008, and we are not presently conducting any such activities. In 2010, third-party oil and gas operators to whom we have leased our minerals drilled seven exploratory wells and 16 productive development wells within units where we own mineral interests. In 2009, third-party oil and gas operators to whom we have leased our minerals drilled seven exploratory wells and 24 productive development wells within units where we own mineral interests. At year-end 2010, there were no wells being drilled by third-party oil and gas operators on units where we own an interest; however, there were two wells that were in some stage of the completion process requiring additional activities prior to generating sales.

Delivery Commitments

We have no oil or natural gas delivery commitments.

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Wells and Acreage

The number of wells owned and operated by third parties to whom we have leased our minerals, as of year-end 2010, 2009 and 2008, follows:

		Wells[a]	
	Oil	Natural Gas	Total
Consolidated entities:			
Year-end 2010	262	209	471
Year-end 2009	262	194	456
Year-end 2008	257	181	438
Ventures accounted for using the equity method:			
Year-end 2010		23	23
Year-end 2009		16	16
Year-end 2008		1	1
Total consolidated and equity method ventures:			
Year-end 2010	262	232	494
Year-end 2009	262	210	472
Year-end 2008	257	182	439

(a) We have royalty interests in all wells at year-end 2010, 2009 and 2008. We also have non-operating working interests in six of these wells at year-end 2010 and 2009 and in three of these wells at year-end 2008. Total net wells from our royalty interests are 43, 41 and 38 at year-end 2010, 2009 and 2008. Net wells from our non-operating working interests are not significant.

We did not have any wells with production of synthetic oil, synthetic natural gas or products of other non-renewable natural resources that are intended to be upgraded into synthetic oil and gas as of year-end 2010, 2009 or 2008. We do not have any plugging liabilities as a royalty interest owner, and we believe any liability as a non-operating working interest owner is not significant.

At year-end 2010, our proved developed acreage includes 30,000 net mineral acres in which we have royalty interests. In addition, we have over 576,000 net undeveloped mineral acres of which 88,000 net acres are leased to third parties for oil and gas exploration and development.

Markets

Oil and gas revenues are influenced by the prices of these commodities as determined by both regional and global markets. Mineral leasing activity is influenced by the location of our mineral interests relative to existing or projected oil and gas reserves and by the proximity of successful extractive efforts to our mineral interests.

Competition

In locations where our mineral interests are close to producing wells and proven reserves, other parties will compete to lease our mineral interests. Conversely, where our mineral interests are close to areas where reserves have not been discovered, we may receive nominal interest in leasing our minerals. When oil and natural gas prices are higher, we are likely to receive greater interest in leasing our minerals close to producing areas because the economics will

support more exploration and extraction activities. Portions of our Texas and Louisiana minerals are proximate to producing wells and proven reserves.

We have little competition from others related to our leasing activities and resulting non-operating working interests. These wells historically have been drilled on or near our owned mineral interests, which allow us to achieve favorable terms from the oil and natural gas operators.

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Fiber Resources

We sell wood fiber from portions of our land, primarily in Georgia, and lease land for recreational uses.

Products

We have over 197,000 acres of timber on our lands and about 18,000 acres of timber under lease. In 2010, we sold at market prices, primarily to Temple-Inland, over 537,000 tons of timber from our lands. We manage our timberland in accordance with the Sustainable Forestry Initiative® program of Sustainable Forestry Initiative, Inc. At year-end 2010, about 198,000 acres of our land, primarily in Georgia, are leased for recreational purposes. Most recreational leases are for a one-year term but may be terminated by us on 30 days notice to the lessee. These leases do not inhibit our ability to harvest timber.

Fiber sales volumes and recreational leasing has decreased due to the sale of over 140,000 acres of timberland in 2010 and 2009.

Information about our principal timber products follows:

	For the Year		
	2010	2009	2008
Pulpwood tons sold	392,900	810,100	917,000
Average pulpwood price per ton	$ 9.93	$ 8.53	$ 8.52
Sawtimber tons sold	144,300	331,300	162,900
Average sawtimber price per ton	$ 17.94	$ 19.82	$ 19.51
Total tons sold	537,200	1,141,400	1,079,900
Average price per ton	$ 12.08	$ 11.81	$ 10.17

Information about our recreational leases follows:

	For the Year		
	2010	2009	2008
Average recreational acres leased	208,100	249,200	287,200
Average price per leased acre	$ 8.32	$ 8.25	$ 7.44

Markets

We have an agreement to sell wood fiber to Temple-Inland at market prices, primarily for use at Temple-Inland s Rome, Georgia mill complex. The agreement expires in 2013 although the purchase and sale commitments are established annually based on our annual harvest plan. Base prices are determined by independent sources and are indexed to third-party sources. Payment for timber is advanced to us by Temple-Inland on a quarterly basis. It is likely that Temple-Inland will continue to be our largest wood fiber customer. We also sell wood fiber to other parties at market prices.

Competition

We face significant competition from other landowners for the sale of our wood fiber. Some of these competitors own similar timber assets that are located in the same or nearby markets. However, due to its weight, the cost for transporting wood fiber long distances is significant, resulting in a competitive advantage for timber that is located reasonably close to paper and building products manufacturing facilities. A significant portion of our wood fiber is reasonably close to such facilities so we expect continued demand for our wood fiber.

Employees

We have 92 employees. None of our employees participate in collective bargaining arrangements. We believe we have a good relationship with our employees.

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Environmental Regulations

Our operations are subject to federal, state and local laws, regulations and ordinances relating to protection of public health and the environment. These changes may adversely affect our ability to harvest and sell timber, develop minerals, remediate contaminated properties or develop real estate. These laws and regulations may relate to, among other things, the protection of timberlands, endangered species, timber harvesting practices, protection and restoration of natural resources, air and water quality, and remedial standards for contaminated property and groundwater. Additionally, these laws may impose liability on property owners or operators for the costs of removal or remediation of hazardous or toxic substances on real property, without regard to whether the owner or operator knew, or was responsible for, the presence of the hazardous or toxic substances. The presence of, or the failure to properly remediate, such substances may adversely affect the value of a property, as well as our ability to sell the property or to borrow funds using that property as collateral or the ability to produce oil and gas from that property. Environmental claims generally would not be covered by our insurance programs.

The particular environmental laws that apply to any given real estate development site vary according to the site s location, its environmental condition, and the present and former uses of the site and adjoining properties. Environmental laws and conditions may result in delays, may cause us to incur substantial compliance or other costs and can prohibit or severely restrict development activity or mineral production in environmentally sensitive regions or areas, which could negatively affect our results of operations.

We own approximately 288 acres in several parcels in or near Antioch, California, portions of which were sites of a Temple-Inland paper manufacturing operation that are in remediation. The remediation is being conducted voluntarily with oversight by the California Department of Toxic Substances Control, or DTSC. The DTSC issued Certificates of Completion for approximately 180 acres in 2006. We estimate the remaining cost to complete remediation activities will be about $2.5 million.

Oil and natural gas operations are subject to numerous federal, state and local laws and regulations controlling the generation, use, storage and discharge of materials into the environment or otherwise relating to the protection of the environment. We participate in wells as a royalty interest owner, and also as a non-operating working interest owner in six wells. We are not an operator with respect to any of the oil and natural gas activities on our properties. Well operators are responsible for compliance with oil and natural gas laws and regulations, which include requiring the operator of oil and natural gas properties to possess permits for the drilling and development of wells, post bonds in connection with various types of activities, and file reports concerning operations.

On December 15, 2009, the Environmental Protection Agency (EPA) finalized its Endangerment Finding, an official finding that emissions of carbon dioxide, methane and other greenhouse gases (GHGs) present an endangerment to human health and the environment because emissions of such gases are, according to EPA, contributing to warming of the Earth s atmosphere and other climatic changes. On November 30, 2010, the EPA issued a final rule requiring reporting of GHG emissions from the oil and gas industry. The adoption and implementation of any regulations imposing reporting obligations on, or limiting emissions of GHGs from, oil and gas operations could increase costs or could adversely affect demand for the oil and gas produced from our lands. In addition, although various climate change legislative measures have been under consideration by the U.S. Congress, it is not possible at this time to predict whether or when Congress may act on climate change legislation.

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Legal Structure

Forestar Group Inc. is a Delaware corporation. The following chart presents the ownership structure for our significant subsidiaries and ventures. It does not contain all our subsidiaries and ventures, some of which are immaterial entities. Except as indicated, all subsidiaries shown are 100 percent owned by their immediate parent.

Our principal executive offices are located at 6300 Bee Cave Road, Building Two, Suite 500, Austin, Texas 78746-5149. Our telephone number is (512) 433-5200.

Available Information

From our Internet website, *http://www.forestargroup.com*, you may obtain additional information about us including:

- our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, including amendments to these reports, and other documents as soon as reasonably practicable after we file them with the Securities and Exchange Commission;

- beneficial ownership reports filed by officers, directors, and principal security holders under Section 16(a) of the Securities Exchange Act of 1934, as amended (or the Exchange Act); and

- corporate governance information that includes our:

  - corporate governance guidelines,

  - audit committee charter,

  - management development and executive compensation committee charter,

  - nominating and governance committee charter,

  - standards of business conduct and ethics,

  - code of ethics for senior financial officers, and

  - information on how to communicate directly with our board of directors.

We will also provide printed copies of any of these documents to any shareholder free of charge upon request. In addition, the materials we file with the SEC may be read and copied at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information about the operation of the Public Reference Room is available by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site (*http://www.sec.gov*) that contains reports, proxy and information statements, and other information that is filed electronically with the SEC.

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Financial Information

Our results of operations, including information regarding our principal business segments, are shown in the Consolidated Financial Statements and the notes thereto beginning on page F-1 to this Annual Report on Form 10-K.

Executive Officers

The names, ages and titles of our executive officers are:

Name	Age	Position
James M. DeCosmo	52	President and Chief Executive Officer
Christopher L. Nines	39	Chief Financial Officer
Craig A. Knight	63	Chief Real Estate Officer
Flavious J. Smith, Jr.	52	Executive Vice President
Phillip J. Weber	50	Executive Vice President
Charles T. Etheredge, Jr.	47	Executive Vice President
David M. Grimm	50	Chief Administrative Officer, General Counsel and Secretary
Charles D. Jehl	42	Chief Accounting Officer

James M. DeCosmo has served as our President and Chief Executive Officer since 2006. He served as Group Vice President of Temple-Inland from 2005 to 2007, as Vice President, Forest from 2000 to 2005 and as Director of Forest Management from 1999 to 2000. Prior to joining Temple-Inland, he held various land management positions throughout the southeastern United States.

Christopher L. Nines has served as our Chief Financial Officer since 2007. He served as Temple-Inland s Director of Investor Relations from 2003 to 2007 and as Corporate Finance Director from 2001 to 2003. He was Senior Vice President of Finance for ConnectSouth Communications, Inc. from 2000 to 2001.

Craig A. Knight has served as our Chief Real Estate Officer since 2006. From 1994 to 2006, he served as President of Lumbermen s Investment Corporation, which changed its name in 2006 to Forestar (USA) Real Estate Group Inc. Mr. Knight was a principal in the real estate development firm of Heath and Knight Properties from 1991 to 1994 and was a partner with Centre Development from 1978 to 1994.

Flavious J. Smith, Jr. has served as our Executive Vice President since 2008. He served as Division Land Manager for EOG Resources, Inc. from 2005 to 2008. He owned and operated Flavious Smith Petroleum Properties, an independent oil and gas operator, from 1989 to 2005, and previously held various leadership positions with several oil and gas and energy-related companies.

Phillip J. Weber has served as our Executive Vice President since October 2009. He served the Federal National Mortgage Association (Fannie Mae) as Senior Vice President Multifamily from 2006 to October 2009, as Chief of Staff to the CEO from 2004 to 2006, and in other management roles prior to 2004.

Charles T. Etheredge, Jr. has served as our Executive Vice President since 2006. He was a member of Guaranty Bank s commercial real estate lending segment from 1992 to 2006, where he served as Senior Vice President and Managing Director for the Eastern Region from 1999 to 2006 and as Vice President and Division Manager from 1997 to 1999.

David M. Grimm has served as our Chief Administrative Officer since 2007, in addition to holding the offices of General Counsel and Secretary since 2006. Mr. Grimm served Temple-Inland as Group General Counsel from 2005 to 2006, Associate General Counsel from 2003 to 2005, and held various other legal positions from 1992 to 2003. Prior to joining Temple-Inland, Mr. Grimm was an attorney in private practice in Dallas, Texas.

Charles D. Jehl has served as our Chief Accounting Officer since 2006. He served as Chief Operations Officer and Chief Financial Officer of Guaranty Insurance Services, Inc. from 2005 to 2006 and as Senior Vice President and Controller from 2000 to 2005. From 1989 to 1999, Mr. Jehl held various financial management positions within Temple-Inland s financial services segment.

Item 1A. *Risk Factors.*

Risks Related to our Real Estate Operations

A continued decrease in demand for new housing in the markets where we operate could decrease our profitability.

The residential development industry is cyclical and is significantly affected by changes in general and local economic conditions, such as employment levels, availability of financing for home buyers, interest rates, consumer confidence and housing demand. Adverse changes in these conditions generally, or in the markets where we operate, could decrease demand for lots for new homes in these areas. The current market conditions include a general over-supply of housing, decreased sales volumes for both new and existing homes, and flat or declining home prices. There also has been significant tightening of mortgage credit standards, decreasing the availability of mortgage loans to acquire new and existing homes. A further decline in housing demand could negatively affect our real estate development activities, which could result in a decrease in our revenues and earnings.

Furthermore, the market value of undeveloped land and lots held by us can fluctuate significantly as a result of changing economic and real estate market conditions. If there are significant adverse changes in economic or real estate market conditions, we may have to hold land in inventory longer than planned. Inventory carrying costs can be significant and can result in losses or lower returns.

Development of real estate entails a lengthy, uncertain, and costly entitlement process.

Approval to develop real property entails an extensive entitlement process involving multiple and overlapping regulatory jurisdictions and often requiring discretionary action by local governments. This process is often political, uncertain and may require significant exactions in order to secure approvals. Real estate projects must generally comply with local land development regulations and may need to comply with state and federal regulations. The process to comply with these regulations is usually lengthy and costly, may not result in the approvals we seek, and can be expected to materially affect our real estate development activities.

Our real estate development operations are currently concentrated in the major markets of Texas, and a significant portion of our undeveloped land holdings are concentrated in Georgia. As a result, our financial results are dependent on the economic growth and strength of those areas.

The economic growth and strength of Texas, where the majority of our real estate development activity is located, are important factors in sustaining demand for our real estate development activities. As a result, any adverse change to the economic growth and health of those areas could materially adversely affect our financial results. The future economic growth in certain portions of Georgia in particular may be adversely affected if its infrastructure, such as roads, utilities, and schools, are not improved to meet increased demand. There can be no assurance that these improvements will occur.

Our real estate development operations are highly dependent upon national, regional, and local homebuilders, as well as other strategic partners, who may have interests that differ from ours and may take actions that adversely affect us.

We are highly dependent upon our relationships with national, regional, and local homebuilders to purchase lots in our residential developments. If homebuilders do not view our developments as desirable locations for homebuilding operations, our business will be adversely affected. Also, a national homebuilder could decide to delay purchases of lots in one of our developments due to adverse real estate conditions wholly unrelated to our areas of operations.

We are also involved in strategic alliances or venture relationships as part of our overall strategy for particular developments or regions. These venture partners may bring development experience, industry expertise, financing capabilities, and local credibility or other competitive attributes. Strategic partners, however, may have economic or business interests or goals that are inconsistent with ours or that are

influenced by factors unrelated to our business. We may also be subject to adverse business consequences if the market reputation or financial condition of a strategic partner deteriorates.

A formal agreement with a venture partner may also involve special risks, such as: we may not have voting control over the venture; the venture partner may take actions contrary to our instructions or requests, or contrary to our policies or objectives with respect to the real estate investments; the venture partner could experience financial difficulties; and actions by a venture partner may subject property owned by the venture to liabilities greater than those contemplated by the venture agreement or have other adverse consequences.

Our customers may be unwilling or unable to meet lot takedown commitments due to liquidity limitations or slowing market conditions.

We enter into contracts to sell lots to builders. Home mortgage credit standards have tightened substantially and many markets have excess housing inventory so fewer new houses are being constructed and sold. Some builders are experiencing liquidity shortfalls and may be unwilling or unable to close on previously committed lot purchases. As a result, we may sell fewer lots and may have lower sales revenues, which could have an adverse effect on our financial position and results of operations.

Our partners inability to fund their capital commitments and otherwise fulfill their operating and financial obligations related to a venture could have an adverse effect on the venture and us.

When we enter into a venture, we may rely on our venture partner to fund its share of capital commitments to the venture and to otherwise fulfill its operating and financial obligations. Failure of a venture partner to timely satisfy its funding or other obligations to the venture could require us to elect whether to increase our financial or other operating support of the venture in order to preserve our investment, which may reduce our returns or cause us to incur losses, or to not fund such obligations, which may subject the venture and us to adverse consequences.

Delays or failures by third parties to take expected actions could reduce our returns or cause us to incur losses on certain real estate development projects.

We rely on governmental utility and special improvement districts to issue bonds as a revenue source for the districts to reimburse us for qualified expenses, such as road and utility infrastructure costs. Bonds must be supported by districts tax revenues, usually from ad valorem taxes. Slowing new home sales, decreasing real estate prices or difficult credit markets for bond sales can reduce or delay district bond sale revenues, causing such districts to delay reimbursement of our qualified expenses. Failure to receive timely reimbursement for qualified expenses could reduce our returns or cause us to incur losses on certain real estate development projects.

We are unable to control the approval or timing of reimbursements or other payments from the special public improvement district (SPID) in which our Cibolo Canyons project is located. Delays or failure by the SPID to approve infrastructure costs for reimbursement or to issue bonds could negatively impact the timing of our future cash flows.

The SPID in which our Cibolo Canyons project is located is an independent governmental entity not affiliated with us. The SPID has an elected governing board comprised of members living within the district, none of whom are affiliated with us. Reimbursement of our infrastructure costs, and timing of payment, is subject to approval and determination by the SPID. The SPID is also obligated to pay to us certain amounts generated from hotel occupancy revenues and other resort sales revenues collected as taxes by the SPID within the district. The amount of revenues collected by the SPID will be impacted by hotel occupancy and resort sales, each of which could be lower than projected. The timing of these payments will be impacted by decisions made by the SPID in regard to whether and

when to issue bonds that would generate funds to support payments to us. Decisions by the SPID to delay approval of reimbursements or issuance of bonds could negatively impact the timing of our future cash flows.

Risks Related to our Mineral Resources Operations

We have limited control over the activities on properties we do not operate.

The properties in which we have an interest are operated by other companies and involve third-party working interest owners. As a result, we have limited ability to influence or control the operation or future development of such properties, including compliance with environmental, safety and other regulations, or the amount of capital expenditures that we will be required to fund with respect to such properties. Moreover, we are dependent on the other working interest owners of such projects to fund their contractual share of the capital expenditures of such projects. These limitations and our dependence on the operator and other working interest owners for these projects could cause us to incur unexpected future costs and materially and adversely affect our financial condition and results of operations.

In addition, operators determine when and where to drill wells and we have no influence over these decisions. New wells may not be productive or may not produce at a level to enable us to recover all or any portion of our capital investment where we have a non-operating working interest.

Volatile oil and natural gas prices could adversely affect our cash flows and results of operations.

Our cash flows and results of operations are dependent in part on oil and natural gas prices, which are volatile. Any substantial or extended decline in the price of oil and natural gas could have a negative impact on our business operations and future revenues. Moreover, oil and natural gas prices depend on factors we cannot control, such as: changes in foreign and domestic supply and demand for oil and natural gas; actions by the Organization of Petroleum Exporting Countries; weather; political conditions in other oil-producing countries, including the possibility of insurgency or war in such areas; prices of foreign exports; domestic and international drilling activity; price and availability of alternate fuel sources; the value of the U.S. dollar relative to other major currencies; the level and effect of trading in commodity markets, the effect of worldwide energy conservation measures, and governmental regulations.

The ability to sell and deliver oil and natural gas produced from wells on our mineral interests could be materially and adversely affected if adequate gathering, processing, compression and transportation services are not obtained.

The sale of oil and natural gas produced from wells on our mineral interests depends on a number of factors beyond our control, including the availability, proximity and capacity of, and costs associated with, gathering, processing, compression and transportation facilities owned by third parties. These facilities may be temporarily unavailable due to market conditions, mechanical reasons or other factors or conditions, and may not be available to us in the future on terms we consider acceptable, if at all. Any significant change in market or other conditions affecting these facilities or the availability of these facilities, including due to our failure or inability to obtain access to these facilities on terms acceptable to us or at all, could materially and adversely affect our business and, in turn, our financial condition and results of operations.

Our reserves and production will decline from their current levels.

The rate of production from oil and natural gas properties generally declines as reserves are produced. Our reserves will decline as they are produced which could materially and adversely affect our future cash flow and results of operations.

A portion of our oil and natural gas production may be subject to interruptions that could have a material and adverse effect on us.

A portion of oil and natural gas production from our minerals may be interrupted, or shut in, from time to time for various reasons, including as a result of accidents, weather conditions, loss of gathering, processing, compression or transportation facility access or field labor issues, or intentionally as a result of market conditions such as oil and natural gas prices that we deem uneconomic. If a substantial amount of

production is interrupted, our cash flow and, in turn, our results of operations could be materially and adversely affected.

We may acquire properties that are not as commercially productive as we initially believed.

From time to time, we may seek to acquire oil and gas properties. Although we perform reviews of properties to be acquired in a manner that we believe is consistent with industry practices, reviews of records and properties may not necessarily reveal existing or potential problems, nor may they permit a buyer to become sufficiently familiar with the properties in order to assess fully their deficiencies and potential. Even when problems with a property are identified, we may assume environmental and other risks and liabilities in connection with acquired properties pursuant to the acquisition agreements. Moreover, there are numerous uncertainties inherent in estimating quantities of oil and gas reserves, actual future production rates and associated costs with respect to acquired properties. Actual reserves, production rates and costs may vary substantially from those assumed in our estimates.

Weather and climate may have a significant and adverse impact on us.

Demand for natural gas is, to a significant degree, dependent on weather and climate, which impacts, among other things, the price we receive for the commodities produced from wells on our mineral interests and, in turn, our cash flow and results of operations. For example, relatively warm temperatures during a winter season generally result in relatively lower demand for natural gas (as less natural gas is used to heat residences and businesses) and, as a result, relatively lower prices for natural gas production.

We do not insure against all potential losses and could be materially and adversely affected by unexpected liabilities.

The exploration for, and production of, oil and natural gas can be hazardous, involving natural disasters and other unforeseen occurrences such as blowouts, cratering, fires and loss of well control, which can damage or destroy wells or production facilities, result in injury or death, and damage property and the environment. We maintain insurance against many, but not all, potential losses or liabilities arising from operations on our property in accordance with what we believe are customary industry practices and in amounts and at costs that we believe to be prudent and commercially practicable. In addition, we require third party operators to maintain customary and commercially practicable types and limits of insurance, but potential losses or liabilities may not be covered by such third party s insurance which may subject us to liability as the mineral estate owner. The occurrence of any of these events and any costs or liabilities incurred as a result of such events could have a material adverse effect on our business, financial condition and results of operations.

Our estimated proved reserves are based on many assumptions that may prove to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

The process of estimating oil and natural gas reserves is complex involving decisions and assumptions in evaluating the available geological, geophysical, engineering and economic data. Accordingly, these estimates are imprecise. Actual future production, oil and natural gas prices, revenues, taxes and quantities of recoverable oil and natural gas reserves might vary from those estimated. Any variance could materially affect the estimated quantities and present value of proved developed reserves. In addition, we may adjust estimates of proved reserves to reflect production history, development, prevailing oil and natural gas prices and other factors, many of which are beyond our control.

Changes in environmental or other regulations for extraction of oil or natural gas could reduce our mineral resource revenues.

An increasing amount of our mineral resources revenue is dependent on newer technologies for extraction of oil or natural gas, specifically hydraulic fracturing. Changes in environmental or other regulations governing

hydraulic fracturing could substantially increase the cost or risk associated with extracting oil or natural gas from our mineral interests, resulting in lower production from our minerals or reduced demand for leasing our minerals. Such changes could result in reduced mineral resources revenues.

Additionally, the U.S. Federal government is currently considering regulations to require the disclosure of chemicals used by the oil and natural gas industry in the hydraulic fracturing process. It has been asserted that chemicals used in the fracturing process could adversely affect drinking water supplies. Such regulations would require the reporting and public disclosure of chemicals used in the fracturing process and could lead to operational restrictions and delays and increased operating costs.

The standardized measure of future net cash flows from our proved reserves is not necessarily the same as the current market value of our estimated reserves. Any material inaccuracies in reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

As required by SEC regulations, we base the estimated discounted future net cash flows from our proved reserves on prices and costs in effect at the time of the estimate. However, actual future net cash flows from our properties will be affected by numerous factors not subject to our control.

The timing of production will affect the timing of actual future net cash flows from proved reserves, and thus their actual present value. In addition, the 10% discount factor we use when calculating discounted future net cash flow, which is required by the SEC, may not be the most appropriate discount factor based on interest rates in effect from time to time and risks associated with us or the oil and natural gas industry in general. Any material inaccuracies in our reserve estimates or underlying assumptions will materially affect the quantities and present value of our reserves.

A significant portion of our Louisiana net mineral acres are subject to prescription under Louisiana law.

A significant portion of our Louisiana net mineral acres were severed from the surface estate shortly before our spin-off. Under Louisiana law, any portions of the mineral estate that are not producing minerals upon the tenth anniversary of severance from the surface estate will revert back to the surface estate owner. Upon such a reversion, we will no longer own such portions of the mineral estate and will no longer have the right to lease, explore or produce from such portions of the mineral estate.

Our water interests may require governmental permits, the consent of third parties and/or completion of significant transportation infrastructure prior to commercialization, all of which are dependent on the actions of others.

Many jurisdictions require governmental permits to withdraw and transport water for commercial uses, the granting of which may be subject to discretionary determinations by such jurisdictions regarding necessity. In addition, we do not own the executory rights related to our non-participating royalty interest, and as a result, third-party consent from the executor rights owner(s) would be required prior to production. The process to obtain permits can be lengthy, and governmental jurisdictions or third parties from whom we seek permits or consent may not provide the approvals we seek. We may be unable to secure a buyer at commercially economic prices for water that we have a right to extract and transport, and transportation infrastructure across property not owned or controlled by us is required for transport of water prior to commercial use. Such infrastructure can require significant capital and may also require the consent of third parties. We may not have cost effective means to transport water from property we own, lease or manage to buyers. As a result, we may lose some or all of our investment in water assets, or our returns may be diminished.

General Risks Related to our Operations

Both our real estate and mineral resources businesses are cyclical in nature.

The operating results of our business segments reflect the general cyclical pattern of each segment. While the cycles of each industry do not necessarily coincide, demand and prices in each may drop substantially in

an economic downturn. Real estate development of residential lots is further influenced by new home construction activity. Mineral resources may be further influenced by national and international commodity prices, principally for oil and natural gas. Cyclical downturns may materially and adversely affect our results of operations.

The real estate and mineral resource industries are highly competitive and a number of entities with which we compete are larger and have greater resources, and competitive conditions may adversely affect our results of operations.

The real estate and mineral resource industries in which we operate are highly competitive and are affected to varying degrees by supply and demand factors and economic conditions, including changes in interest rates, new housing starts, home repair and remodeling activities, credit availability, housing affordability and federal energy policies. No single company is dominant in any of our industries. The competitive conditions in the real estate industry may result in difficulties acquiring suitable land at acceptable prices, lower sales volumes and prices, increased development costs, and delays in construction.

We compete with numerous regional and local developers for the acquisition, entitlement, and development of land suitable for development. We also compete with some of our national and regional home builder customers who develop real estate for their own use in homebuilding operations, many of which are larger and have greater resources, including greater marketing and technology budgets. Any improvement in the cost structure or service of our competitors will increase the competition we face.

Our business and results of operations may be negatively affected by the existence of these conditions.

Our activities are subject to environmental regulations and liabilities that could have a negative effect on our operating results.

Our operations are subject to federal, state, and local laws and regulations related to the protection of the environment. Compliance with these provisions may result in delays, may cause us to invest substantial funds to ensure compliance with applicable environmental regulations and can prohibit or severely restrict timber harvesting, real estate development or mineral production activity in environmentally sensitive regions or areas.

Significant reductions in cash flow from slowing real estate, mineral resources or fiber resources market conditions could lead to higher levels of indebtedness, limiting our financial and operating flexibility.

We must comply with various covenants contained in our senior credit facility, and any other future debt arrangements. Significant reductions in cash flow from slowing real estate, mineral resources or fiber resources market conditions could lead to higher levels of indebtedness, limiting our financial and operating flexibility, and ultimately limiting our ability to comply with our debt covenants. If we fail to comply with the terms of any of our debt covenants, our lenders will have the right to accelerate the maturity of that debt and foreclose upon the collateral securing that debt. Realization of any of these factors could adversely affect our financial condition and results of operations.

Debt within some of our ventures may not be renewed or may be difficult or more expensive to replace.

Some of our ventures have debt, a substantial portion of which is non-recourse to us. Many lenders have substantially curtailed or ceased making real estate acquisition and development loans. When debt within our ventures matures, some of our ventures may be unable to renew existing loans or secure replacement financing, or replacement financing may be more expensive. If our ventures are unable to renew existing loans or secure replacement financing, we may be required to contribute additional equity to our ventures which could increase our risk or increase our borrowings

under our senior credit facility, or both. If our ventures secure replacement financing that is more expensive, our profits may be reduced.

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If the spin-off is determined to be taxable for U.S. federal income tax purposes, we could incur significant U.S. federal income tax liabilities.

Temple-Inland has received a private letter ruling from the Internal Revenue Service, or IRS, that the spin-off qualifies for tax-free treatment under applicable sections of the Code. In addition, Temple-Inland has received an opinion from tax counsel that the spin-off so qualifies. The IRS ruling and the opinion rely on certain representations, assumptions, and undertakings, including those relating to the past and future conduct of our business, and neither the IRS ruling nor the opinion would be valid if such representations, assumptions, and undertakings were incorrect. Notwithstanding the IRS private letter ruling and opinion, the IRS could determine that the spin-off should be treated as a taxable transaction if it determines that any of the representations, assumptions, or undertakings that were included in the request for the private letter ruling are false or have been violated or if it disagrees with the conclusions in the opinion that are not covered by the IRS ruling. If the spin-off fails to qualify for tax-free treatment, under a tax matters agreement between Temple-Inland and us, we may be required to indemnify Temple-Inland against any tax resulting from the distribution to the extent that such tax resulted from any of our representations or undertakings being incorrect or violated. If we are required to indemnify Temple-Inland or such other persons under the circumstances set forth in the tax matters agreement, we may be subject to substantial liabilities.

Item 1B. ***Unresolved Staff Comments.***

None.

Item 2. ***Properties.***

Our principal executive offices are located in Austin, Texas, where we lease approximately 32,000 square feet of office space from Palisades West, LLC, a venture in which we own a 25 percent interest. We also lease office space in Dallas, Texas; Fort Worth, Texas; Lufkin, Texas; and Atlanta, Georgia. We believe these offices are suitable for conducting our business.

For a description of our properties in our real estate, mineral resources and fiber resources segments, see Business Real Estate , Business Mineral Resources and Business Fiber Resources , respectively, in Part I, Item 1 of this Annual Report on Form 10-K.

Item 3. ***Legal Proceedings.***

We are involved directly or through ventures in various legal proceedings that arise from time to time in the ordinary course of doing business. We believe we have established adequate reserves for any probable losses and that the outcome of any of the proceedings should not have a material adverse effect on our financial position or long-term results of operations or cash flows. It is possible, however, that charges related to these matters could be significant to results of operations or cash flow in any single accounting period.

Item 4. ***Reserved.***

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Market Information

Our common stock is traded on the New York Stock Exchange. The high and low sales prices in each quarter in 2010 and 2009 were:

	2010 Price Range		2009 Price Range	
	High	**Low**	**High**	**Low**
First Quarter	$ 22.85	$ 16.80	$ 13.50	$ 5.74
Second Quarter	23.54	16.23	14.17	7.36
Third Quarter	18.32	13.21	18.39	10.32
Fourth Quarter	19.78	16.47	22.98	14.31
For the Year	23.54	13.21	22.98	5.74

Shareholders

Our stock transfer records indicated that as of February 25, 2011, there were approximately 3,969 holders of record of our common stock.

Dividend Policy

We currently intend to retain any future earnings to support our business and do not anticipate paying cash dividends in the foreseeable future. The declaration and payment of any future dividends will be at the discretion of our Board of Directors after taking into account various factors, including without limitation, our financial condition, earnings, capital requirements of our business, the terms of any credit agreements to which we may be a party at the time, legal requirements, industry practice, and other factors that our Board of Directors deems relevant.

Issuer Purchases of Equity Securities(1)

Period	Total Number of Shares Purchased(2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs

Month 1 (10/1/2010 10/31/2010)		$	5,999,013
Month 2 (11/1/2010 11/30/2010)	646	$ 18.20	5,999,013
Month 3 (12/1/2010 12/31/2010)		$	5,999,013
Total	646		

(1) On February 11, 2009, we announced that our Board of Directors authorized the repurchase of up to 7,000,000 shares of our common stock. In third quarter 2010, we repurchased 1,000,987 shares of our common stock at a cost of $15,178,000 or $15.16 average price paid per share. We have no plans or programs that expired during the period covered by the table above and no plans or programs that we intend to terminate prior to expiration or under which we no longer intend to make further purchases.

(2) Represents shares withheld to pay taxes in connection with vesting of restricted stock awards and exercises of stock options.

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Performance Graph

We composed an index of our peers consisting of Avatar Holdings Inc., Consolidated-Tomoka Land Co., Tejon Ranch Co. and The St. Joe Company (Peer Index). Our cumulative total shareholder return following our spin-off compared to the Russell 2000 Index and to the Peer Index was as shown in the following graph (assuming $100 invested on January 1, 2008):

Pursuant to SEC rules, returns of each of the companies in the Peer Index are weighted according to the respective company s stock market capitalization at the beginning of each period for which a return is indicated.

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Item 6. ***Selected Financial Data.***

	For the Year				
	2010	2009	2008	2007	2006
	(In thousands, except per share amounts)				
Revenues:					
Real estate	$ 68,269	$ 94,436	$ 98,859	$ 142,729	$ 180,151
Mineral resources	24,790	36,256	47,671	20,818	27,980
Fiber resources	8,301	15,559	13,192	14,439	17,429
Total revenues	$ 101,360	$ 146,251	$ 159,722	$ 177,986	$ 225,560
Segment earnings (loss):					
Real estate	$ (4,634)	$ 3,182	$ 9,075	$ 39,507	$ 70,271
Mineral resources	22,783	32,370	44,076	18,581	26,305
Fiber resources	5,058	9,622	8,896	7,950	6,711
Total segment earnings	23,207	45,174	62,047	66,038	103,287
Items not allocated to segments:					
General and administrative	(17,341)	(22,399)	(19,318)	(17,413)	(14,048)
Share-based compensation	(11,596)	(11,998)	(4,516)	(1,397)	(1,275)
Gain on sale of assets[a]	28,607	104,047			
Interest expense	(16,446)	(20,459)	(21,283)	(9,229)	(6,229)
Other non-operating income[b]	1,164	375	279	705	79
Income before taxes	7,595	94,740	17,209	38,704	81,814
Income tax expense	(2,470)	(35,633)	(5,235)	(13,909)	(29,970)
Net income	$ 5,125	$ 59,107	$ 11,974	$ 24,795	$ 51,844
Diluted net income per common share[c]	$ 0.14	$ 1.64	$ 0.33	$ 0.70	$ 1.47
Average diluted common shares outstanding[c]	36,377	36,102	35,892	35,380	35,380
At year-end:					
Assets	$ 789,324	$ 784,734	$ 834,576	$ 748,726	$ 620,174
Debt	$ 221,589	$ 216,626	$ 337,402	$ 266,015	$ 161,117
Noncontrolling interest	$ 4,715	$ 5,879	$ 6,660	$ 8,629	$ 7,746
Forestar Group Inc. shareholders /Parent s equity	$ 509,564	$ 512,456	$ 447,292	$ 433,201	$ 418,052
Ratio of total debt to total capitalization	30%	29%	43%	38%	27%

[a] Gain on sale of assets represents gains from timberland sales in accordance with our near-term strategic initiatives announced first quarter 2009.

(b) In 2010, other non-operating income principally represents interest income related to a loan to a third-party equity investor in the resort development located at our Cibolo Canyons development. We received payment in full plus interest in fourth quarter 2010.

(c) Prior to December 28, 2007, we were a wholly-owned subsidiary of Temple-Inland Inc. For 2007 and 2006, we computed diluted net income per share based upon the number of shares of our common stock distributed by Temple-Inland on December 28, 2007.

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

Forward-Looking Statements

This Annual Report on Form 10-K and other materials we have filed or may file with the Securities and Exchange Commission contain forward-looking statements within the meaning of the federal securities laws. These forward-looking statements are identified by their use of terms and phrases such as believe, anticipate, could, estimat likely, intend, may, plan, expect, and similar expressions, including references to assumptions. These statements reflect our current views with respect to future events and are subject to risk and uncertainties. We note that a variety of factors and uncertainties could cause our actual results to differ significantly from the results discussed in the forward-looking statements. Factors and uncertainties that might cause such differences include, but are not limited to:

general economic, market or business conditions in Texas or Georgia, where our real estate activities are concentrated;

the opportunities (or lack thereof) that may be presented to us and that we may pursue;

significant customer concentration

future residential or commercial entitlements, development approvals and the ability to obtain such approvals;

accuracy of estimates and other assumptions related to investment in real estate, the expected timing and pricing of land and lot sales and related cost of real estate sales, impairment of long-lived assets, income taxes, share-based compensation and oil and natural gas reserves;

the levels of resale housing inventory and potential impact of foreclosures in our development projects and the regions in which they are located;

the development of relationships with strategic partners;

fluctuations in costs and expenses;

demand for new housing, which can be affected by a number of factors including the availability of mortgage credit;

supply of and demand for oil and natural gas and fluctuations in oil and natural gas prices;

competitive actions by other companies;

changes in governmental policies, laws or regulations and actions or restrictions of regulatory agencies;

government regulation of exploration and production technology, including hydraulic fracturing;

the results of financing efforts, including our ability to obtain financing with favorable terms;

our partners ability to fund their capital commitments and otherwise fulfill their operating and financial obligations;

water withdrawal or usage may be subject to state and local laws, regulations or permit requirements, and there is no assurance that all our water interests or rights will be available for withdrawal or use; and

the final resolutions or outcomes with respect to our contingent and other liabilities related to our business.

Other factors, including the risk factors described in Item 1A of this Annual Report on Form 10-K, may also cause actual results to differ materially from those projected by our forward-looking statements. New factors emerge from time to time and it is not possible for us to predict all such factors, nor can we assess the impact of any such factor on our business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement.

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Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

Background

On December 28, 2007, Temple-Inland distributed all of the issued and outstanding shares of our common stock to its stockholders in a transaction commonly referred to as a spin-off.

Strategy

Our strategy is:

- Recognizing and responsibly delivering the greatest value from every acre; and
- Growing through strategic and disciplined investments.

In 2009, we announced our near-term strategic initiatives to enhance shareholder value by: generating significant cash flow, principally from the sale of about 175,000 acres of higher and better use timberland; reducing debt by approximately $150,000,000; and repurchasing up to 20 percent of our common stock.

In 2009, we sold about 95,000 acres of timber and timberland in Georgia and Alabama for $158,603,000 in two transactions generating combined net proceeds of $153,851,000, which were principally used to reduce debt and pay taxes. These transactions resulted in a combined gain on sale of assets of $104,047,000.

In 2010, we sold about 24,000 acres of timber and timberland in Georgia, Alabama and Texas for $38,778,000 in seven transactions generating combined net proceeds of $38,040,000, which were principally used to reinvest in qualifying real estate under Internal Revenue Code (IRC) Section 1031. These transactions resulted in a combined gain on sale of assets of $28,607,000. In addition, in third quarter 2010, we repurchased 1,000,987 shares of our common stock at a cost of $15,178,000.

At year-end 2010, assets held for sale under these strategic initiatives includes about 55,000 acres of undeveloped land with a carrying value of $14,513,000 and related timber with a carrying value of $6,609,000. Though we continue to actively market this land, market conditions for timberland have deteriorated since second quarter 2009 principally due to increased investor return requirements, limited availability of financing and alternate investment options for buyers in the marketplace. We are a disciplined seller, and as a result, additional time will be required to complete the sale of these assets.

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Results of Operations for the Years Ended 2010, 2009 and 2008

A summary of our consolidated results follows:

	2010	For the Year 2009 (In thousands)	2008
Revenues:			
Real estate	$ 68,269	$ 94,436	$ 98,859
Mineral resources	24,790	36,256	47,671
Fiber resources	8,301	15,559	13,192
Total revenues	$ 101,360	$ 146,251	$ 159,722
Segment earnings (loss):			
Real estate	$ (4,634)	$ 3,182	$ 9,075
Mineral resources	22,783	32,370	44,076
Fiber resources	5,058	9,622	8,896
Total segment earnings	23,207	45,174	62,047
Items not allocated to segments:			
General and administrative	(17,341)	(22,399)	(19,318)
Share-based compensation	(11,596)	(11,998)	(4,516)
Gain on sale of assets	28,607	104,047	
Interest expense	(16,446)	(20,459)	(21,283)
Other non-operating income	1,164	375	279
Income before taxes	7,595	94,740	17,209
Income tax expense	(2,470)	(35,633)	(5,235)
Net income	$ 5,125	$ 59,107	$ 11,974

Significant aspects of our results of operations follow:

2010

Real estate segment earnings declined principally due to lower undeveloped land sales from our retail sales program. In addition, segment earnings include $11,271,000 of non-cash impairment charges principally associated with residential development projects located near Atlanta, Georgia and Fort Worth, Texas and with a commercial real estate project near the Texas gulf coast.

Mineral resources segment earnings declined principally due to decreased lease bonus revenues as a result of reduced leasing activity by exploration and production companies that are now concentrating investments in drilling activities to hold existing leases rather than leasing new mineral interests in our basins. This decline in lease bonus revenue was partially offset by increased oil and natural gas production and higher oil prices, including our share of venture activity.

Fiber resources segment earnings decreased principally due to reduced harvest activity resulting from the sale of over 140,000 acres of timberland in 2010 and 2009 and postponing harvest plans on about 55,000 acres classified as held for sale.

Gain on sale of assets represents the sale of about 24,000 acres of timber and timberland in Georgia, Alabama and Texas for $38,778,000 in accordance with our near-term strategic initiatives.

Interest expense decreased principally due to lower interest rates as a result of the maturity of our interest rate swap agreement and decreased amortization of prepaid loan fees due to refinancing and extending our senior credit facility in 2010.

2009

Real estate segment earnings were negatively impacted by $10,619,000 of non-cash impairment charges principally associated with a residential condominium project located in Austin, Texas, two joint-venture projects located in Tampa, Florida and an equity investment in an unconsolidated venture. Segment earnings were also negatively impacted by $3,702,000 in environmental remediation charges.

Mineral resources segment earnings declined principally due to lower royalty revenues as result of lower natural gas and oil prices, and to a lesser extent, lower lease bonus revenues from decreased leasing activity and increased infrastructure costs associated with developing our mineral resources organization.

Fiber resources segment earnings increased principally due to increased volumes and higher prices related to a higher mix of larger pine sawtimber sold from our Texas forest.

General and administrative expenses include about $3,200,000 paid to outside advisors regarding an evaluation by our Board of Directors of an unsolicited shareholder proposal and $2,213,000 in non-cash impairment charges related to the sale of our undivided 15 percent interest in corporate aircraft contributed to us by Temple-Inland at spin-off.

Share-based compensation increased principally due to our higher stock price and increased number of cash-settled equity awards.

Gain on sale of assets represents the sale of about 95,000 acres of timber and timberland in Georgia and Alabama for $158,603,000 in accordance with our near-term strategic initiatives.

Interest expense decreased as result of lower debt levels.

2008

Real estate segment earnings were negatively impacted by decreased sales of residential lots, decreased commercial sales activity, increased costs associated with environmental remediation, and asset impairments.

Mineral resources segment earnings benefited from bonus payments received for leasing over 61,500 net mineral acres. Mineral resources segment earnings also benefited from increased production volumes from new well activity and higher average oil and natural gas prices.

General and administrative expenses increased as a result of costs associated with the development of corporate functions as well as start-up costs necessary as a stand-alone public company.

Share-based compensation expense increased primarily due to accelerated expense recognition in conjunction with awards granted to retirement-eligible employees and an increase in the number of participants in our plan.

Interest expense increased as a result of higher debt levels and higher borrowing costs.

Current Market Conditions

Current U.S. market conditions in the single-family residential industry continue to be difficult, characterized by depressed sales volumes and prices, increased foreclosures, high unemployment rates and low consumer confidence. While all markets are being negatively affected by overall poor economic conditions, not all geographic areas and products have been affected to the same extent or with equal severity. These difficult market conditions may continue throughout 2011.

Oil prices have increased partially due to tightening of international supply and anticipation that future demand will outpace supply growth as global economic activity improves. Natural gas prices have remained depressed as production remains strong and U.S. domestic demand is lower resulting in increased inventory levels. In our areas of operations, exploration and production companies remain focused on reducing capital expenditures for lease acquisition due to lower natural gas prices and drilling activity to hold existing leases. These conditions may impact the demand for new mineral leases, new exploration activity and the amount of royalty revenues we receive.

Pulpwood demand is relatively stable in our markets. Sawtimber prices remain depressed due to decreased demand for lumber as a result of lower new home construction activity.

Business Segments

We manage our operations through three business segments:

- Real estate,
- Mineral resources, and
- Fiber resources.

We evaluate performance based on earnings before unallocated items and income taxes. Segment earnings (loss) consist of operating income, equity in earnings (loss) of unconsolidated ventures and net income (loss) attributable to noncontrolling interests. Unallocated items consist of general and administrative expenses, share-based compensation, gain on sale of assets, interest expense and other non-operating income and expense. The accounting policies of the segments are the same as those described in the accounting policy note to the consolidated financial statements.

We operate in cyclical industries. Our operations are affected to varying degrees by supply and demand factors and economic conditions including changes in interest rates, availability of mortgage credit, consumer and home builder sentiment, new housing starts, real estate values, employment levels, changes in the market prices for oil, natural gas, and timber, and the overall strength or weakness of the U.S. economy.

Real Estate

We own directly or through ventures over 220,000 acres of real estate located in nine states and 12 markets. Our real estate segment secures entitlements and develops infrastructure on our lands, primarily for single-family residential and mixed-use communities. We own about 167,000 acres in a broad area around Atlanta, Georgia, with the balance located primarily in Texas. We target investments principally in our strategic growth corridors, regions across the southern half of the United States that possess key demographic and growth characteristics that we believe make them attractive for long-term real estate investment. We own and manage our projects either directly or through ventures. Our real estate segment revenues are principally derived from the sales of residential single-family lots, undeveloped land and commercial real estate and to a lesser degree from the operation of income producing properties, primarily a hotel and a multifamily property.

In addition, on December 29, 2010, we acquired a 401 unit, Class A multifamily property in Houston, Texas for $49,100,000. Results of operations for this acquisition, included in income producing properties, were not significant in 2010. Pro forma real estate segment earnings assuming this acquisition occurred at the beginning of 2009 would not be significantly different than those reported.

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A summary of our real estate results follows:

	For the Year		
	2010	2009	2008
		(In thousands)	
Revenues	$ 68,269	$ 94,436	$ 98,859
Cost of sales	(46,225)	(46,307)	(55,131)
Operating expenses	(28,598)	(34,319)	(35,898)
	(6,554)	13,810	7,830
Equity in earnings (loss) of unconsolidated ventures	2,629	(8,161)	3,480
Less: Net income attributable to noncontrolling interests	(709)	(2,467)	(2,235)
Segment (loss) earnings	$ (4,634)	$ 3,182	$ 9,075

In 2010, cost of sales includes $9,042,000 in non-cash impairment charges principally associated with residential development projects located near Atlanta, Georgia and Fort Worth, Texas. Operating expenses principally consist of $7,205,000 in property taxes, $6,188,000 in employee compensation and benefits, $4,471,000 in professional services, $2,826,000 in depreciation, $1,716,000 in community maintenance and $1,142,000 in marketing and advertising.

In 2010, equity in earnings (loss) of unconsolidated ventures includes about $4,869,000 in gains that were previously deferred by us due to our continuing involvement with the property. In fourth quarter 2010, the property was sold to a third party. In addition, equity in earnings (loss) of unconsolidated ventures includes $2,229,000 in non-cash impairment charges primarily related to a commercial real estate project located near the Texas gulf coast.

In 2009, cost of sales includes $5,718,000 in non-cash impairment charges related principally to a residential condominium project located in Austin, Texas. Operating expenses principally consist of $9,115,000 in property taxes, $6,112,000 in employee compensation and benefits, $3,532,000 in professional services, $2,167,000 in depreciation, $2,054,000 in community maintenance, $1,212,000 in marketing and advertising and $3,702,000 related to environmental remediation charges.

In 2009, equity in earnings (loss) of unconsolidated ventures includes $4,901,000 in non-cash impairment charges related to two residential real estate projects located in Tampa, Florida and an equity investment in an unconsolidated venture.

In 2008, cost of sales includes $3,000,000 in non-cash impairment charges related to wholly-owned residential real estate projects, principally in Texas. Operating expenses principally consist of $10,030,000 in property taxes, $8,109,000 in employee compensation and benefits, $2,909,000 in professional services, $2,076,000 in depreciation, $1,342,000 in community maintenance, $2,345,000 in marketing and advertising, and $3,007,000 related to environmental remediation activities. Segment earnings benefited from $943,000 in recovered project infrastructure costs from an improvement district related to a project in Texas in which we no longer have an investment.

Revenues in our owned and consolidated ventures consist of:

For the Year

	2010	2009	2008
		(In thousands)	
Residential real estate	$ 24,540	$ 27,677	$ 38,110
Commercial real estate	352	793	9,440
Undeveloped land	20,111	46,580	26,005
Income producing properties	21,225	18,214	21,488
Other	2,041	1,172	3,816
Total revenues	$ 68,269	$ 94,436	$ 98,859

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Units sold in our owned and consolidated ventures consist of:

	For the Year		
	2010	2009	2008
Residential real estate:			
Lots sold	442	483	812
Average price per lot sold	$ 55,076	$ 53,469	$ 45,712
Commercial real estate:			
Acres sold	2	2	55
Average price per acre sold	$ 146,047	$ 433,406	$ 172,346
Undeveloped land:			
Acres sold	5,812	18,204	5,577
Average price per acre sold	$ 3,460	$ 2,550	$ 4,663

Residential real estate revenues principally consist of the sale of single-family lots to national, regional and local homebuilders. In 2010 and 2009, residential real estate revenues declined principally as a result of decreased demand for single-family lots due to the overall decline in the housing industry. In 2008, average prices for residential lots sold were negatively impacted by the sale of 192 high density lots for approximately $24,300 per lot.

The decrease in commercial real estate revenues in 2010 and 2009 is attributable to limited availability of commercial real estate acquisition and development mortgages to potential third-party purchasers.

In 2010, undeveloped land sales decreased due to current market conditions significantly influenced by limited availability of financing and alternate investment options to buyers in the marketplace. However, average price per acre sold increased principally as a result of selling about 700 acres of land in the entitlement process in Georgia for about $8,200 per acre. As market conditions for residential and commercial real estate sales began to deteriorate in 2008, we allocated additional internal resources and focused our strategic marketing efforts toward sale of undeveloped land through our retail land sales program. In 2009, we sold 18,204 acres from our owned and consolidated ventures at an average price of $2,550 per acre, generating about $46,420,000 in revenues.

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Information about our real estate projects and our real estate ventures follows:

	Year-End	
	2010	2009
Owned and consolidated ventures:		
Entitled, developed and under development projects		
Number of projects	54	54
Residential lots remaining	17,780	20,186
Commercial acres remaining	1,774	1,702
Undeveloped land and land in the entitlement process		
Number of projects	18	19
Acres in entitlement process	29,670	30,370
Acres undeveloped[a]	168,724	198,063
Ventures accounted for using the equity method:		
Ventures lot sales (for the year)		
Lots sold	362	159
Average price per lot sold	$ 42,602	$ 60,589
Ventures entitled, developed and under development projects		
Number of projects	22	21
Residential lots remaining	9,634	8,961
Commercial acres sold (for the year)	15	4
Average price per acre sold	$ 81,318	$ 188,144
Commercial acres remaining	590	645
Ventures undeveloped land and land in the entitlement process		
Number of projects		2
Acres in entitlement process		1,080
Acres sold (for the year)		1
Average price per acre sold	$	$ 10,000
Acres undeveloped	5,731	5,517

(a) Includes 55,000 acres classified as assets held for sale.

Mineral Resources

We own directly or through ventures about 606,000 net acres of mineral interests. Our mineral resources segment revenues are principally derived from royalties and other lease revenues from our mineral interests located principally in Texas, Louisiana, Georgia and Alabama. At year-end 2010, we have about 88,000 net acres under lease and about 30,000 net acres held by production.

In addition, on December 22, 2010, we acquired a water resources company for $12,000,000. It is focused on providing sustainable volumes of ground water to central Texas and the Interstate-35 growth corridor and its principal assets are approximately 17,800 acres of ground water leases. Results of operations for this acquisition were not significant in 2010. Pro forma mineral resources segment earnings assuming this acquisition had occurred at the beginning of 2009 would not be significantly different from those reported.

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A summary of our mineral resources results follows:

	For the Year		
	2010	2009	2008
	(In thousands)		
Revenues	$ 24,790	$ 36,256	$ 47,671
Cost of sales	(1,097)	(922)	(1,714)
Operating expenses	(2,982)	(3,354)	(3,043)
	20,711	31,980	42,914
Equity in earnings of unconsolidated ventures	2,072	390	1,162
Segment earnings	$ 22,783	$ 32,370	$ 44,076

Cost of sales represents our share of oil and natural gas production severance taxes, which are calculated based on a percentage of oil and natural gas produced and costs related to our non-operating working interests. In 2009, these expenses were partially offset by a refund of $255,000 related to well status changes approved by the Texas Railroad Commission.

In 2010, operating expenses principally consist of $1,182,000 in employee compensation and benefits, $566,000 in professional services, $269,000 in depreciation, $255,000 in property taxes and $244,000 in information technology.

In 2009, operating expenses principally consist of $1,299,000 in employee compensation and benefits, $872,000 in professional services, $184,000 in depreciation, $301,000 in property taxes and $257,000 in information technology.

In 2008, operating expenses principally consist of $911,000 in employee compensation and benefits, $1,251,000 in professional services as we resourced our operations with a contract workforce while recruiting our minerals team, and $250,000 in property taxes.

In 2010 and 2009, equity in earnings of unconsolidated ventures includes our share of royalty revenue from new wells that began producing from the Barnett Shale natural gas formation. In 2008, equity in earnings of unconsolidated ventures includes our share of a lease bonus payment as result of leasing 241 net mineral acres for $1,568,000.

Revenues consist of:

	For the Year		
	2010	2009	2008
	(In thousands)		
Royalties	$ 13,724	$ 11,910	$ 21,639
Other lease revenues	11,066	24,346	26,032
Total revenues	$ 24,790	$ 36,256	$ 47,671

In 2010, royalty revenues increased as a result of higher oil prices and oil production partially offset by decreases in natural gas production in owned and consolidated properties. Increased oil prices contributed $1,873,000 while production increases contributed $466,000. The production increase primarily relates to new oil wells commencing production in late 2009 and early 2010. At year-end 2010, there were 494 active wells owned and operated by others on our leased mineral acres.

In 2010, other lease revenues include $7,655,000 in lease bonus payments as a result of leasing about 16,900 net mineral acres for an average of $453 per acre and $2,168,000 related to delay rental payments. In addition, other lease revenues include about $1,126,000 as a result of an option exercised to extend an existing lease on over 3,200 acres.

In 2009, royalty revenues declined principally due to lower natural gas and oil prices, which were partially offset by higher production volume principally due to the increased number of new wells

commencing production. At year-end 2009, there were 472 active wells owned and operated by others on our leased mineral acres.

In 2009, other lease revenues include $21,333,000 in lease bonus payments as a result of leasing over 25,800 net mineral acres for an average of $827 per acre and $2,530,000 from delay rental payments. This leasing activity was located principally in Trinity County, Texas.

In 2008, royalty revenues increased principally due to higher natural gas prices. At year-end 2008, there were 439 active wells owned and operated by others on our leased mineral acres.

In 2008, other lease revenues include $23,356,000 in lease bonus payments as a result of leasing over 61,300 net mineral acres for an average of $381 per acre and $1,986,000 from delay rental payments. The leasing activity was located principally in East Texas and was driven by our proximity to the Cotton Valley, James Lime and Bossier-Haynesville natural gas formations.

Oil and natural gas produced and average unit prices related to our royalty and non-operating working interests follows:

	For the Year		
	2010	**2009**	**2008**
Consolidated entities:			
Oil production (barrels)	115,400	107,200	87,900
Average price per barrel	$ 73.09	$ 56.85	$ 106.66
Natural gas production (millions of cubic feet)	1,223.6	1,411.6	1,363.4
Average price per thousand cubic feet	$ 4.32	$ 4.12	$ 8.76
Our share of ventures accounted for using the equity method:			
Natural gas production (millions of cubic feet)	572.8	82.1	
Average price per thousand cubic feet	$ 4.12	$ 3.80	$
Total consolidated and our share of equity method ventures:			
Oil production (barrels)	115,400	107,200	87,900
Average price per barrel	$ 73.09	$ 56.85	$ 106.66
Natural gas production (millions of cubic feet)	1,796.4	1,493.7	1,363.4
Average price per thousand cubic feet	$ 4.26	$ 4.10	$ 8.76

Our share of ventures natural gas production increased as a result of 16 wells that began producing from the Barnett Shale natural gas formation in 2010.

A summary of our mineral acres[(a)] at year-end 2010 follows:

	2018				2017			
Pension expense:	CDT	GXS GER	GXS PHP	Total	CDT	GXS GER	GXS PHP	Total
Service cost	$130	$123	$210	$463	$115	$97	$196	$408
Interest cost	158	127	62	347	113	93	51	257
Amortization of actuarial (gains) and losses	141	19	(59)	101	155	42	(12)	185

Net pension expense	$429	$269	$213	$911	$383	$232	$235	$850

	Nine Months Ended March 31,							
	2018				2017			
Pension expense:	CDT	GXS GER	GXS PHP	Total	CDT	GXS GER	GXS PHP	Total
Service cost	$379	$357	$657	$1,393	$347	$292	$838	$1,477
Interest cost	459	370	176	1,005	339	279	172	790
Amortization of actuarial (gains) and losses	409	55	(182)	282	465	125	(36)	554
Net pension expense	$1,247	$782	$651	$2,680	$1,151	$696	$974	$2,821

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In determining the fair value of the pension plan benefit obligations as of March 31, 2018 and June 30, 2017, respectively, we used the following weighted-average key assumptions:

	As of March 31, 2018			As of June 30, 2017		
	CDT	GXS GER	GXS PHP	CDT	GXS GER	GXS PHP
Assumptions:						
Salary increases	2.00%	2.00%	6.20%	2.00%	2.00%	6.20%
Pension increases	1.75%	2.00%	N/A	1.75%	2.00%	N/A
Discount rate	2.05%	2.05%	7.00%	2.00%	2.00%	5.00%
Normal retirement age	65	65-67	60	65	65-67	60
Employee fluctuation rate:						
to age 20	—%	—%	12.19%	—%	—%	12.19%
to age 25	—%	—%	16.58%	—%	—%	16.58%
to age 30	1.00%	—%	13.97%	1.00%	—%	13.97%
to age 35	0.50%	—%	10.77%	0.50%	—%	10.77%
to age 40	—%	—%	7.39%	—%	—%	7.39%
to age 45	0.50%	—%	3.28%	0.50%	—%	3.28%
to age 50	0.50%	—%	—%	0.50%	—%	—%
from age 51	1.00%	—%	—%	1.00%	—%	—%

Anticipated pension payments under the pension plans for the fiscal years indicated below are as follows:

	Fiscal years ending June 30,		
	CDT	GXS GER	GXS PHP
2018 (three months ended June 30)	$159	$253	$25
2019	706	1,042	115
2020	760	1,050	154
2021	858	1,095	194
2022	945	1,106	297
2023 to 2027	5,912	5,895	2,056
Total	$9,340	$10,441	$2,841

Other Plans

Other plans include defined benefit pension plans that are offered by certain of our foreign subsidiaries. Many of these plans were assumed through our acquisitions or are required by local regulatory requirements. These other plans are primarily unfunded, with the aggregate projected benefit obligation included in our pension liability. The net periodic costs of these plans are determined using the projected unit credit method and several actuarial assumptions, the most significant of which are the discount rate and estimated service costs.

NOTE 12—SHARE CAPITAL, OPTION PLANS AND SHARE-BASED PAYMENTS

Cash Dividends

For the three and nine months ended March 31, 2018, pursuant to the Company's dividend policy, we declared total non-cumulative dividends of $0.1320 and $0.3960, respectively, per Common Share in the aggregate amount of $35.2 million and $105.0 million, respectively, which we paid during the same period.

For the three and nine months ended March 31, 2017, pursuant to the Company's dividend policy, we paid total non-cumulative dividends of $0.1150 and $0.3450, respectively, per Common Share in the aggregate amount of $30.3 million and $86.0 million, respectively.

Share Capital
Our authorized share capital includes an unlimited number of Common Shares and an unlimited number of Preference Shares. No Preference Shares have been issued.
Treasury Stock
Repurchase
During the three and nine months ended March 31, 2018, we did not repurchase any of our Common Shares for potential reissuance under our Long-Term Incentive Plans (LTIP) or other plans (three and nine months ended March 31, 2017—123,785 Common Shares, respectively, in the amount of $4.2 million, respectively). See below for more details on our various plans.
From time to time we may provide funds to an independent agent to facilitate repurchases of our Common Shares in connection with the settlement of awards under the LTIP or other plans.
Reissuance
During the three and nine months ended March 31, 2018, we reissued 20,000 and 407,443 Common Shares, respectively, from treasury stock (three and nine months ended March 31, 2017—44,000 and 393,922 Common Shares, respectively), in connection with the settlement of awards.
Share-Based Payments
Total share-based compensation expense for the periods indicated below is detailed as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Stock options	$983	$2,365	$7,014	$9,040
Performance Share Units (issued under LTIP)	751	926	2,723	2,754
Restricted Share Units (issued under LTIP)	1,588	1,573	4,987	4,940
Restricted Share Units (other)	146	534	823	2,029
Deferred Share Units (directors)	701	558	2,193	1,899
Employee Share Purchase Plan	911	705	2,733	1,711
Total share-based compensation expense	$5,080	$6,661	$20,473	$22,373

Summary of Outstanding Stock Options
As of March 31, 2018, an aggregate of 6,846,680 options to purchase Common Shares were outstanding and an additional 11,311,338 options to purchase Common Shares were available for issuance under our stock option plans. Our stock options generally vest over four years and expire between seven and ten years from the date of the grant. Currently we also have options outstanding that vest over five years, as well as options outstanding that vest based on meeting certain market conditions. The exercise price of all our options is set at an amount that is not less than the closing price of our Common Shares on the NASDAQ on the trading day immediately preceding the applicable grant date.
A summary of activity under our stock option plans for the nine months ended March 31, 2018 is as follows:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value ($'000s)
Outstanding at June 30, 2017	8,977,830	$ 24.57		
Granted	848,830	34.55		
Exercised	(2,683,814)	18.68		
Forfeited or expired	(296,166)	30.48		
Outstanding at March 31, 2018	6,846,680	$ 27.86	4.48	$ 47,591
Exercisable at March 31, 2018	2,303,668	$ 23.91	3.22	$ 25,095

We estimate the fair value of stock options using the Black-Scholes option-pricing model or, where appropriate, the Monte Carlo Valuation Method, consistent with the provisions of ASC Topic 718, "Compensation—Stock Compensation" (Topic 718) and SEC Staff Accounting Bulletin No. 107. The option-pricing models require input of subjective assumptions, including the estimated life of the option and the expected volatility of the underlying stock over the estimated life of the option. We use historical volatility as a basis for projecting the expected volatility of the underlying stock and estimate the expected life of our stock options based upon historical data.

We believe that the valuation techniques and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair value of our stock option grants. Estimates of fair value are not intended, however, to predict actual future events or the value ultimately realized by employees who receive equity awards.

For the periods indicated, the weighted-average fair value of options and weighted-average assumptions were as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Weighted–average fair value of options granted	$8.14	$7.32	$7.48	$6.86
Weighted-average assumptions used:				
Expected volatility	26.95 %	27.64 %	27.10 %	28.61 %
Risk–free interest rate	2.44 %	1.70 %	1.83 %	1.32 %
Expected dividend yield	1.45 %	1.37 %	1.45 %	1.42 %
Expected life (in years)	4.33	4.34	4.42	4.33
Forfeiture rate (based on historical rates)	6 %	5 %	6 %	5 %
Average exercise share price	$36.50	$33.48	$34.55	$31.34

As of March 31, 2018, the total compensation cost related to the unvested stock option awards not yet recognized was approximately $18.5 million, which will be recognized over a weighted-average period of approximately 2.4 years.

No cash was used by us to settle equity instruments granted under share-based compensation arrangements in any of the periods presented.

We have not capitalized any share-based compensation costs as part of the cost of an asset in any of the periods presented.

For the three and nine months ended March 31, 2018, cash in the amount of $30.5 million and $50.1 million, respectively, was received as the result of the exercise of options granted under share-based payment arrangements. The tax benefit realized by us during the three and nine months ended March 31, 2018 from the exercise of options eligible for a tax deduction was $0.6 million and $0.9 million, respectively.

For the three and nine months ended March 31, 2017, cash in the amount of $12.2 million and $16.7 million, respectively, was received as the result of the exercise of options granted under share-based payment arrangements. The tax benefit realized by us during the three and nine months ended March 31, 2017 from the exercise of options eligible for a tax deduction was $1.5 million and $1.9 million, respectively.

Long-Term Incentive Plans

We incentivize our executive officers, in part, with long-term compensation pursuant to our LTIP. The LTIP is a rolling three year program that grants eligible employees a certain number of target Performance Share Units (PSUs) and/or Restricted Share Units (RSUs). Target PSUs become vested upon the achievement of certain financial and/or operational performance criteria (the Performance Conditions) that are determined at the time of the grant. Target RSUs become vested when an eligible employee remains employed throughout the vesting period. LTIP grants that have recently vested, or have yet to vest, are described below. LTIP grants are referred to in this Quarterly Report on Form 10-Q based upon the year in which the grants are expected to vest.

Fiscal 2017 LTIP

Grants made in Fiscal 2015 under the LTIP (collectively referred to as Fiscal 2017 LTIP), consisting of PSUs and RSUs, took effect in Fiscal 2015 starting on September 4, 2014. We settled the Fiscal 2017 LTIP by issuing 312,651 Common Shares from treasury stock during the three months ended December 31, 2017, with a cost of $6.7 million.

Fiscal 2018 LTIP

Grants made in Fiscal 2016 under the LTIP (collectively referred to as Fiscal 2018 LTIP), consisting of PSUs and RSUs, took effect in Fiscal 2016 starting on August 23, 2015. The Performance Conditions for vesting of the PSUs are based solely upon market conditions. The RSUs are employee service-based awards and vest over the life of the Fiscal 2018 LTIP. We expect to settle the Fiscal 2018 LTIP awards in stock.

Fiscal 2019 LTIP

Grants made in Fiscal 2017 under the LTIP (collectively referred to as Fiscal 2019 LTIP), consisting of PSUs and RSUs, took effect in Fiscal 2017 starting on August 14, 2016. The Performance Conditions for vesting of the PSUs are based solely upon market conditions. The RSUs are employee service-based awards and vest over the life of the Fiscal 2019 LTIP. We expect to settle the Fiscal 2019 LTIP awards in stock.

Fiscal 2020 LTIP

Grants made in Fiscal 2018 under the LTIP (collectively referred to as Fiscal 2020 LTIP), consisting of PSUs and RSUs, took effect in Fiscal 2018 starting on August 7, 2017. The Performance Conditions for vesting of the PSUs are based solely upon market conditions. The RSUs are employee service-based awards and vest over the life of the Fiscal 2020 LTIP. We expect to settle the Fiscal 2020 LTIP awards in stock.

PSUs and RSUs granted under the LTIPs have been measured at fair value as of the effective date, consistent with Topic 718, and will be charged to share-based compensation expense over the remaining life of the plan. Stock options granted under the LTIPs have been measured using the Black-Scholes option-pricing model, consistent with Topic 718. We estimate the fair value of PSUs using the Monte Carlo pricing model and RSUs have been valued based upon their grant date fair value.

As of March 31, 2018, the total expected compensation cost related to the unvested LTIP awards not yet recognized was $15.2 million, which is expected to be recognized over a weighted average period of 1.9 years.

Restricted Share Units (RSUs)

During the three and nine months ended March 31, 2018, we granted nil and 4,464 RSUs, respectively, to employees in accordance with employment and other agreements (three and nine months ended March 31, 2017—nil and 7,800 RSUs, respectively). The RSUs vest over a specified contract date, typically three years from the respective date of grants. We expect to settle the awards in stock.

During the three and nine months ended March 31, 2018, we issued 20,000 and 94,792 Common Shares, respectively, from treasury stock, with a cost of $0.4 million and $2.0 million, respectively, in connection with the settlement of these vested RSUs (three and nine months ended March 31, 2017—44,000 and 54,000 Common Shares, respectively, with a cost of $1.0 million and $1.1 million, respectively).

Deferred Stock Units (DSUs)

During the three and nine months ended March 31, 2018, we granted 3,037 and 83,846 DSUs, respectively, to certain non-employee directors (three and nine months ended March 31, 2017—2,302 and 77,998 DSUs, respectively). The DSUs were issued under our Deferred Share Unit Plan. DSUs granted as compensation for director fees vest immediately, whereas all other DSUs granted vest at our next annual general meeting following the granting of the DSUs. No DSUs are payable by us until the director ceases to be a member of the Board.

Employee Share Purchase Plan (ESPP)

Our ESPP offers employees a purchase price discount of 15%.

During the three and nine months ended March 31, 2018, 201,726 and 540,343 Common Shares, respectively, were eligible for issuance to employees enrolled in the ESPP (three and nine months ended March 31, 2017—129,579 and 349,435 Common Shares, respectively).

During the three and nine months ended March 31, 2018, cash in the amount of approximately $5.8 million and $15.9 million, respectively, was received from employees relating to the ESPP (three and nine months ended March 31, 2017—$3.8 million and $10.0 million, respectively).

NOTE 13—GUARANTEES AND CONTINGENCIES

We have entered into the following contractual obligations with minimum payments for the indicated fiscal periods as follows:

	Payments due between				
	Total	April 1, 2018—June 30, 2018	July 1, 2018—June 30, 2020	July 1, 2020—June 30, 2022	July 1, 2022 and beyond
Long-term debt obligations [1]	$3,424,525	$ 186,654	$ 389,329	$ 953,792	$ 1,894,750
Operating lease obligations [2]	397,539	20,530	140,044	105,496	131,469
Purchase obligations	17,867	2,622	14,439	806	—
	$3,839,931	$ 209,806	$ 543,812	$ 1,060,094	$ 2,026,219

[1] Includes interest up to maturity and principal payments. We currently have borrowings outstanding under the Revolver ($275 million as of March 31, 2018), which we expect to repay within the next 12 months. Please see note 10 "Long-Term Debt" for more details.

[2] Net of $8.6 million of sublease income to be received from properties which we have subleased to third parties.

Guarantees and Indemnifications

We have entered into customer agreements which may include provisions to indemnify our customers against third party claims that our software products or services infringe certain third party intellectual property rights and for liabilities related to a breach of our confidentiality obligations. We have not made any material payments in relation to such indemnification provisions and have not accrued any liabilities related to these indemnification provisions in our Condensed Consolidated Financial Statements.

Occasionally, we enter into financial guarantees with third parties in the ordinary course of our business, including, among others, guarantees relating to taxes and letters of credit on behalf of parties with whom we conduct business. Such agreements have not had a material effect on our results of operations, financial position or cash flows.

Litigation

We are currently involved in various claims and legal proceedings.

Quarterly, we review the status of each significant legal matter and evaluate such matters to determine how they should be treated for accounting and disclosure purposes in accordance with the requirements of ASC Topic 450-20 "Loss Contingencies" (Topic 450-20). Specifically, this evaluation process includes the centralized tracking and itemization of the status of all our disputes and litigation items, discussing the nature of any litigation and claim, including any dispute or claim that is reasonably likely to result in litigation, with relevant internal and external counsel, and assessing the progress of each matter in light of its merits and our experience with similar proceedings under similar circumstances.

If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss in accordance with Topic 450-20. As of the date of this Quarterly Report on Form 10-Q, the aggregate of such estimated losses was not material to our consolidated financial position or result of operations and we do not believe as of the date of this filing that it is reasonably possible that a loss exceeding the amounts already recognized will be incurred that would be material to our consolidated financial position or results of operations.

Contingencies

IRS Matter

As we have previously disclosed, the United States Internal Revenue Service (IRS) is examining certain of our tax returns for our fiscal year ended June 30, 2010 (Fiscal 2010) through our fiscal year ended June 30, 2012 (Fiscal 2012), and in connection with those examinations is reviewing our internal reorganization in Fiscal 2010 to consolidate certain intellectual property ownership in Luxembourg and Canada and our integration of certain acquisitions into the resulting structure. We also previously disclosed that the examinations may lead to proposed adjustments to our taxes that may be material, individually or in the aggregate, and that we have not recorded any material accruals for any such potential adjustments in our Condensed Consolidated Financial Statements.

As part of these examinations, which remain ongoing, on July 17, 2015 we received from the IRS an initial Notice of Proposed Adjustment (NOPA) in draft form proposing a one-time approximately $280 million increase to our U.S. federal taxes arising from the reorganization in Fiscal 2010 and proposing penalties equal to 20% of the additional

taxes, plus interest at the applicable statutory rate (which will continue to accrue until the matter is resolved and may be substantial). A NOPA is an IRS

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position and does not impose an obligation to pay tax. The draft NOPA may be changed before the final NOPA is issued, including because the IRS reserved the right in the draft NOPA to increase the adjustment. Based on discussions with the IRS, we expect we will receive an additional NOPA proposing an approximately $80 million increase to our U.S. federal taxes for Fiscal 2012 arising from the integration of Global 360 Holding Corp. into the structure that resulted from the reorganization, accompanied by proposed penalties and interest (although there can be no assurance that this will be the amount reflected in the NOPA when received, including because the IRS may assign a higher value to our intellectual property). Depending upon the outcome of these matters, additional state income taxes plus penalties and interest may be due. We currently estimate that, as of March 31, 2018, adjustments under the draft NOPA in its present form and the anticipated additional NOPA could result in an aggregate liability of approximately $605 million, inclusive of U.S. federal and state taxes, penalties and interest. The increase from the initially disclosed estimated aggregate liability is solely due to an estimate of interest that has accrued.

We strongly disagree with the IRS' position and intend to vigorously contest the proposed adjustments to our taxable income. We are examining various alternatives available to taxpayers to contest the proposed adjustments. Any such alternatives could involve a lengthy process and result in the incurrence of significant expenses. As of the date of this Quarterly Report on Form 10-Q, we have not recorded any material accruals in respect of these examinations in our Condensed Consolidated Financial Statements. An adverse outcome of these tax examinations could have a material adverse effect on our financial position and results of operations.

CRA Matter

As part of its ongoing audit of our Canadian tax returns, the Canada Revenue Agency (CRA) has disputed our transfer pricing methodology used for certain intercompany transactions with our international subsidiaries. The CRA has issued a notice of reassessment for Fiscal 2012 that would, as drafted, increase our taxable income for that year by approximately $90 million (offset by the tax attributes referred to below) and apply a penalty of approximately 10%. We strongly disagree with the CRA position and believe the reassessment of Fiscal 2012 (including penalties) is without merit. We will continue to vigorously contest both the proposed adjustments to our taxable income and the penalty assessment. We have filed a notice of objection and will also seek competent authority consideration under applicable international treaties in respect of this reassessment. As of the date of this Quarterly Report on Form 10-Q, we have not recorded any accruals in respect of this reassessment in our Condensed Consolidated Financial Statements.

Even if we are unsuccessful in challenging the CRA's reassessment to increase our taxable income for Fiscal 2012, we have elective deductions available in Fiscal 2012 that would offset such increased amount so that no additional cash tax would be payable for Fiscal 2012, exclusive of any proposed penalties. Audits by the CRA of our tax returns for fiscal years prior to Fiscal 2012 have been completed with no reassessment of our income tax liability in respect of our international transactions, including the transfer pricing methodology applied to them. The CRA is currently auditing Fiscal 2013, Fiscal 2014 and Fiscal 2015, and has proposed to reassess Fiscal 2013 in a manner consistent with the reassessment of Fiscal 2012. We are in ongoing discussions with the CRA and continue to vigorously contest the CRA's audit position.

GXS Brazil Matter

As part of our acquisition of GXS, we inherited a tax dispute in Brazil between the Company's subsidiary, GXS Tecnologia da Informação (Brasil) Ltda. (GXS Brazil), and the municipality of São Paulo, in connection with GXS Brazil's judicial appeal of a tax claim. During the first quarter of Fiscal 2018 the courts ruled in favour of the municipality of São Paulo. The Company decided not to pursue further appeal. On October 1, 2017, the Company reached a settlement with the municipality and paid $1.4 million.

Historically, prior to our acquisition of GXS, GXS would charge certain costs to its subsidiaries, including GXS Brazil, primarily based on historical transfer pricing studies that were intended to reflect the costs incurred by subsidiaries in relation to services provided by the parent company to the subject subsidiary. GXS recorded taxes on amounts billed, that were considered to be due based on the intercompany charges. GXS subsequently re-evaluated its intercompany charges to GXS Brazil and related taxes and, upon taking into consideration the current environment and judicial proceedings in Brazil, concluded that it was probable that certain indirect taxes would be assessable and payable based upon the accrual of such intercompany charges and has approximately $1.8 million accrued for the probable amount of a settlement related to the indirect taxes, interest and penalties.

GXS India Matter

Our Indian subsidiary, GXS India Technology Centre Private Limited (GXS India), is subject to potential assessments by Indian tax authorities in the city of Bangalore. GXS India has received assessment orders from the Indian tax authorities alleging that the transfer price applied to intercompany transactions was not appropriate. Based on advice from our tax advisors, we believe that the facts that the Indian tax authorities are using to support their assessment are incorrect. We have filed appeals

and anticipate an eventual settlement with the Indian tax authorities. We have accrued $1.4 million to cover our anticipated financial exposure in this matter.

Please also see Part II, Item 1A "Risk Factors" elsewhere in this Quarterly Report on Form 10-Q.

NOTE 14—INCOME TAXES

Our effective tax rate represents the net effect of the mix of income earned in various tax jurisdictions that are subject to a wide range of income tax rates.

We recognize interest expense and penalties related to income tax matters in income tax expense.

For the three and nine months ended March 31, 2018 and 2017, we recognized the following amounts as income tax-related interest expense and penalties:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Interest expense	$18	$1,673	$3,915	$4,456
Penalties expense (recoveries)	453	6	(90)	(318)
Total	$471	$1,679	$3,825	$4,138

The following amounts have been accrued on account of income tax-related interest expense and penalties:

	As of March 31, 2018	As of June 30, 2017
Interest expense accrued *	$52,094	$47,402
Penalties accrued *	$2,325	$2,160

* These balances have been included within "Long-term income taxes payable" within the Condensed Consolidated Balance Sheets.

We believe that it is reasonably possible that the gross unrecognized tax benefits, as of March 31, 2018, could decrease tax expense in the next 12 months by $7.5 million, relating primarily to the expiration of competent authority relief and tax years becoming statute barred for purposes of future tax examinations by local taxing jurisdictions.

Our four most significant tax jurisdictions are Canada, the United States, Luxembourg and Germany. Our tax filings remain subject to audits by applicable tax authorities for a certain length of time following the tax year to which those filings relate. The earliest fiscal years open for examination are 2009 for Germany, 2010 for the United States, 2011 for Luxembourg, and 2012 for Canada.

We are subject to tax audits in all major taxing jurisdictions in which we operate and currently have tax audits open in Canada, the United States, France, Germany, India, Malaysia, and the United Kingdom. On a quarterly basis we assess the status of these examinations and the potential for adverse outcomes to determine the adequacy of the provision for income and other taxes. Statements regarding the United States and Canada audits are included in note 13 "Guarantees and Contingencies".

The timing of the resolution of income tax audits is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ from the amounts accrued. It is reasonably possible that within the next 12 months we will receive additional assessments by various tax authorities or possibly reach resolution of income tax audits in one or more jurisdictions. These assessments or settlements may or may not result in changes to our contingencies related to positions on tax filings. The actual amount of any change could vary significantly depending on the ultimate timing and nature of any settlements. We cannot currently provide an estimate of the range of possible outcomes. For more information relating to certain tax audits, please refer to note 13 "Guarantees and Contingencies".

As at March 31, 2018, we have provided $28.3 million (June 30, 2017—$22.1 million) in respect of both additional foreign taxes or deferred income tax liabilities for temporary differences related to the undistributed earnings of certain non-United States subsidiaries, and planned periodic repatriations from certain United States and German subsidiaries, that will be subject to withholding taxes upon distribution. We have not provided for additional foreign

withholding taxes or deferred income tax liabilities related to undistributed earnings of all other non-Canadian subsidiaries, since such earnings are considered permanently invested in those subsidiaries, or are not subject to withholding taxes. It is not practicable to reasonably estimate the amount of additional deferred income tax liabilities or foreign withholding taxes that may be payable should these earnings be distributed in the future.
The effective tax rate decreased to a provision of 25.5% for the three months ended March 31, 2018, from a provision of 37.9% for the three months ended March 31, 2017. Tax expense increased by $6.9 million, primarily due to (i) the impact of

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changes in US tax legislation in Fiscal 2018 resulting in a provisional expense of $4.7 million (see below), (ii) an increase of $8.2 million on account of the Company having higher income before taxes, including the impact of foreign tax rates, and (iii) an increase of $1.4 million relating to differences in tax filings from provisions, offset by (i) a decrease of $5.7 million resulting from the net impact of reversals and accruals of reserves, and (ii) a decrease of $1.2 million relating to a decrease in amortization of deferred charges. The remainder of the difference was due to normal course movements and non-material items.

The effective tax rate increased to a provision of 35.8% for the nine months ended March 31, 2018, compared to a recovery of 496.3% for the nine months ended March 31, 2017. The increase in tax expense of $916.0 million was primarily due to (i) a significant tax benefit of $876.1 million resulting from the Fiscal 2017 internal reorganization as described below which did not reoccur in Fiscal 2018, (ii) the impact of changes in US tax legislation in Fiscal 2018 resulting in a provisional charge of $20.0 million (see below), and (iii) an increase of $25.3 million on account of the Company having higher income before taxes, including the impact of foreign tax rates, offset by (i) a decrease of $0.5 million resulting from the net impact of reversals and accruals of reserves, (ii) a decrease of $1.2 million relating to differences in tax filings from provisions, and (iii) a decrease of $3.3 million relating to a decrease in amortization of deferred charges. The remainder of the difference was due to normal course movements and non-material items.

In July 2016, we implemented a reorganization of our subsidiaries worldwide with the view to continuing to enhance operational and administrative efficiencies through further consolidated ownership, management, and development of our intellectual property (IP) in Canada, continuing to reduce the number of entities in our group and working towards our objective of having a single operating legal entity in each jurisdiction. A significant tax benefit of $876.1 million, associated primarily with the recognition of a net deferred tax asset arising from the entry of the IP into Canada, was recognized in the first quarter of Fiscal 2017. For more information relating to this, please refer to our Annual Report on Form 10-K for the year ended June 30, 2017.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act, which significantly changed the existing US tax laws, including a reduction in the federal corporate tax rate from 35% to 21%, and the transition of US international taxation from a worldwide tax system to a territorial tax system. As a result of the enactment of the legislation, the Company incurred a provisional one-time tax expense of $4.7 million for the three months ended March 31, 2018 and $20.0 million for the nine months ended March 31, 2018, respectively, primarily related to the transition tax on accumulated foreign earnings and the re-measurement of certain deferred tax assets and liabilities. The portion of this anticipated increase to tax expense attributable to the transition tax is payable over a period of up to eight years. The impact of the $20.0 million adjustment resulting from the US legislation on the effective tax rate is an increase of 6.0% for the three months ended March 31, 2018 and an increase of 7.1% for the nine months ended March 31, 2018.

The $20.0 million is a provisional amount in respect of rate change, Alternative Minimum Tax (AMT), and foreign earnings in accordance with Staff Accounting Bulletin 118 “Income Tax Accounting Implications of the Tax Cuts and Jobs Act” (SAB 118). The finalization of the provisional one-time amount is pending finalization of the re-assessment of the timing of reversals of certain deferred tax assets and liabilities and additional considerations related to undistributed foreign earnings and evaluating whether any portion of our existing AMT credit carryforwards are not expected to be refundable as a result of the repeal of corporate AMT. Additional information such as final Fiscal 2018 income and detailed earnings and profits calculations for foreign subsidiaries may result in changes to the provisional amount during the SAB 118 measurement period.

The Company continues to assess the impact of the new law on its consolidated financial statements and anticipates finalizing the determination on or before December 22, 2018 in accordance with SAB 118.

NOTE 15—FAIR VALUE MEASUREMENT

ASC Topic 820 “Fair Value Measurement” (Topic 820) defines fair value, establishes a framework for measuring fair value, and addresses disclosure requirements for fair value measurements. Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value, in this context, should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk, including our own credit risk.

In addition to defining fair value and addressing disclosure requirements, Topic 820 establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which are determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

- Level 1—inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

- Level 2—inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis:
Our financial assets and liabilities measured at fair value on a recurring basis consisted of the following types of instruments as of March 31, 2018 and June 30, 2017:

	March 31, 2018				June 30, 2017			
		Fair Market Measurements using:				Fair Market Measurements using:		
	March 31, 2018	Quoted prices in active markets for identical assets/ (liabilities) (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	June 30, 2017	Quoted prices in active markets for identical assets/ (liabilities) (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Financial Assets:								
Marketable securities	N/A	N/A	N/A	N/A	$3,023	N/A	$ 3,023	N/A
Derivative financial instrument asset (note 16)	—	N/A	—	N/A	1,174	N/A	1,174	N/A
	$—	N/A	$ —	N/A	$4,197	N/A	$ 4,197	N/A
Financial Liabilities:								
Derivative financial instrument liability (note 16)	$(618)	N/A	$ (618)	N/A	$—	N/A	$ —	N/A
	$(618)	N/A	$ (618)	N/A	$—	N/A	$ —	N/A

Our valuation techniques used to measure the fair values of the derivative instruments, the counterparty to which has high credit ratings, were derived from pricing models including discounted cash flow techniques, with all significant inputs derived from or corroborated by observable market data, as no quoted market prices exist for these instruments. Our discounted cash flow techniques use observable market inputs, such as, where applicable, foreign currency spot and forward rates.
Our cash and cash equivalents, along with our accounts receivable and accounts payable and accrued liabilities balances, are measured and recognized in our Condensed Consolidated Financial Statements at an amount that approximates their fair value (a Level 2 measurement) due to their short maturities.
If applicable, we will recognize transfers between levels within the fair value hierarchy at the end of the reporting period in which the actual event or change in circumstance occurs. During the three and nine months ended March 31, 2018 and 2017, we did not have any transfers between Level 1, Level 2 or Level 3.
Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis
We measure certain assets and liabilities at fair value on a nonrecurring basis. These assets and liabilities are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the three and nine months ended March 31, 2018 and 2017, no indications of impairment were identified and therefore no fair value measurements were required.
Marketable Securities

Marketable securities are classified as available for sale securities and are recorded within "Other assets" on our Condensed Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of Accumulated other comprehensive income. We did not hold any marketable securities as of March 31, 2018.

A summary of our marketable securities outstanding as of March 31, 2018 and June 30, 2017 is as follows:

	As of March 31, 2018				As of June 30, 2017			
	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value	Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
Marketable securities	N/A	N/A	N/A	N/A	$2,406	$ 617	$ —	$ 3,023

NOTE 16—DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Foreign Currency Forward Contracts

We are engaged in hedging programs with various banks to limit the potential foreign exchange fluctuations incurred on future cash flows relating to a portion of our Canadian dollar payroll expenses. We operate internationally and are therefore exposed to foreign currency exchange rate fluctuations in the normal course of our business, in particular to changes in the Canadian dollar on account of large costs that are incurred from our centralized Canadian operations, which are denominated in Canadian dollars. As part of our risk management strategy, we use foreign currency forward contracts to hedge portions of our payroll exposure with typical maturities of between one and twelve months. We do not use derivatives for speculative purposes.

We have designated these transactions as cash flow hedges of forecasted transactions under ASC Topic 815 “Derivatives and Hedging” (Topic 815). As the critical terms of the hedging instrument and of the entire hedged forecasted transaction are the same, in accordance with Topic 815, we have been able to conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. Accordingly, quarterly unrealized gains or losses on the effective portion of these forward contracts have been included within other comprehensive income. The fair value of the contracts, as of March 31, 2018, is recorded within "Accounts payable and accrued liabilities”.

As of March 31, 2018, the notional amount of forward contracts we held to sell U.S. dollars in exchange for Canadian dollars was $47.3 million (June 30, 2017—$39.0 million).

Fair Value of Derivative Instruments and Effect of Derivative Instruments on Financial Performance

The effect of these derivative instruments on our Condensed Consolidated Financial Statements for the periods indicated below were as follows (amounts presented do not include any income tax effects).

Fair Value of Derivative Instruments in the Condensed Consolidated Balance Sheets (see note 15 "Fair Value Measurement")

		As of March 31, 2018	As of June 30, 2017
Derivatives	Balance Sheet Location	Fair Value Asset (Liability)	Fair Value Asset (Liability)
Foreign currency forward contracts designated as cash flow hedges	Prepaid expenses and other current assets (Accounts payable and accrued liabilities)	$ (618)	$ 1,174

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Effects of Derivative Instruments on Income and Other Comprehensive Income (OCI)
Three and Nine Months Ended March 31, 2018

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Three Months Ended March 31, 2018	Nine Months Ended March 31, 2018		Three Months Ended March 31, 2018	Nine Months Ended March 31, 2018		Three Months Ended March 31, 2018	Nine Months Ended March 31, 2018
Foreign currency forward contracts	$ (1,273)	$ 247	Operating expenses	$ 423	$ 2,039	N/A	$ —	$ —

Three and Nine Months Ended March 31, 2017

Derivatives in Cash Flow Hedging Relationship	Amount of Gain or (Loss) Recognized in OCI on Derivatives (Effective Portion)		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)		Location of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain or (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Three Months Ended March 31, 2017	Nine Months Ended March 31, 2017		Three Months Ended March 31, 2017	Nine Months Ended March 31, 2017		Three Months Ended March 31, 2017	Nine Months Ended March 31, 2017
Foreign currency forward contracts	$ 473	$ (960)	Operating expenses	$ (54)	$ 92	N/A	$ —	$ —

NOTE 17—SPECIAL CHARGES (RECOVERIES)

Special charges (recoveries) include costs and recoveries that relate to certain restructuring initiatives that we have undertaken from time to time under our various restructuring plans, as well as acquisition-related costs and other charges.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Fiscal 2018 Restructuring Plan	$553	$—	$8,907	$—
Fiscal 2017 Restructuring Plan	525	18,888	3,947	20,744
Restructuring Plans prior to Fiscal 2017 Restructuring Plan	4	(68)	260	(1,872)
Acquisition-related costs	1,172	4,639	4,625	15,305
Other charges (recoveries)	390	(2,873)	3,651	9,980
Total	$2,644	$20,586	$21,390	$44,157

Fiscal 2018 Restructuring Plan

During Fiscal 2018 and in the context of our acquisitions of Covisint, Guidance and subsequently Hightail (each defined below), we began to implement restructuring activities to streamline our operations (collectively referred to as the Fiscal 2018 Restructuring Plan). The Fiscal 2018 Restructuring Plan charges relate to workforce reductions and facility consolidations. These charges require management to make certain judgments and estimates regarding the amount and timing of restructuring charges or recoveries. Our estimated liability could change subsequent to its recognition, requiring adjustments to the expense and the liability recorded. On a quarterly basis, we conduct an evaluation of the related liabilities and expenses and revise our assumptions and estimates as appropriate.

As of March 31, 2018, we expect total costs to be incurred in conjunction with the Fiscal 2018 Restructuring Plan to be approximately $12.0 million, of which $8.9 million has already been recorded within "Special charges (recoveries)" to date.
A reconciliation of the beginning and ending liability for the nine months ended March 31, 2018 is shown below.

Fiscal 2018 Restructuring Plan	Workforce reduction	Facility costs	Total
Balance payable as at June 30, 2017	$ —	$ —	$—
Accruals and adjustments	7,977	930	8,907
Cash payments	(8,637)	(187)	(8,824)
Foreign exchange and other non-cash adjustments	912	(85)	827
Balance payable as at March 31, 2018	$ 252	$ 658	$910

Fiscal 2017 Restructuring Plan
During Fiscal 2017 and in the context of our acquisitions of Recommind, CCM Business and ECD Business (each as defined below), we began to implement restructuring activities to streamline our operations (collectively referred to as the Fiscal 2017 Restructuring Plan). The Fiscal 2017 Restructuring Plan charges relate to workforce reductions and facility consolidations. These charges require management to make certain judgments and estimates regarding the amount and timing of restructuring charges or recoveries. Our estimated liability could change subsequent to its recognition, requiring adjustments to the expense and the liability recorded. On a quarterly basis, we conduct an evaluation of the related liabilities and expenses and revise our assumptions and estimates as appropriate.
As of March 31, 2018, we expect total costs to be incurred in conjunction with the Fiscal 2017 Restructuring Plan to be approximately $45.0 million, of which $37.5 million has already been recorded within "Special charges (recoveries)" to date.
A reconciliation of the beginning and ending liability for the nine months ended March 31, 2018 is shown below.

Fiscal 2017 Restructuring Plan	Workforce reduction	Facility costs	Total
Balance payable as at June 30, 2017	$ 10,045	$ 1,369	$11,414
Accruals and adjustments	3,371	576	3,947
Cash payments	(12,068)	(1,312)	(13,380)
Foreign exchange and other non-cash adjustments	590	(19)	571
Balance payable as at March 31, 2018	$ 1,938	$ 614	$2,552

Acquisition-related costs
Included within "Special charges (recoveries)" for the three and nine months ended March 31, 2018 are costs incurred directly in relation to acquisitions in the amount of $1.2 million and $4.6 million, respectively (three and nine months ended March 31, 2017—$4.6 million and $15.3 million, respectively).
Other charges (recoveries)
ERP Implementation Costs
During Fiscal 2018, we implemented a broad enterprise resource planning (ERP) system.
For the three and nine months ended March 31, 2018, we recorded charges of nil and $3.5 million, respectively, relating to the implementation of this project (three and nine months ended March 31, 2017—$2.6 million and $7.3 million, respectively).
Other charges (recoveries)
For the three months ended March 31, 2018, "Other charges" include $1.7 million relating to system implementation costs and $0.9 million relating to other miscellaneous charges. These charges were partially offset by a recovery of $2.2 million relating to certain pre-acquisition sales and use tax liabilities becoming statute barred.
For the nine months ended March 31, 2018, "Other charges" include $1.7 million relating to system implementation costs and $3.0 million relating to miscellaneous other charges. These charges were partially offset by (i) $2.3 million relating to certain pre-acquisition sales and use tax liabilities that were recovered outside of the acquisition's one year measurement period and (ii) $2.2 million relating to certain pre-acquisition sales and use tax liabilities becoming statute barred.

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For the three months ended March 31, 2017, "Other recoveries" primarily include (i) a net recovery of $2.7 million relating to commitment fees, (ii) $1.6 million relating to a recovery on certain interest on pre-acquisition liabilities becoming statute barred, and (iii) $1.3 million relating to a recovery on certain pre-acquisition sales and use tax liabilities being released upon becoming statute barred.

For the nine months ended March 31, 2017, "Other charges" primarily include (i) a net charge of $6.5 million relating to commitment fees and (ii) $1.2 million relating to post-acquisition integration costs necessary to streamline an acquired company into our operations. These charges were partially offset by (i) a recovery of $3.8 million relating to certain pre-acquisition sales and use tax liabilities being released upon becoming statute barred and (ii) $1.4 million relating to a recovery on certain interest on pre-acquisition liabilities becoming statute barred. The remaining amounts relate to miscellaneous other charges.

NOTE 18—ACQUISITIONS

Fiscal 2018 Acquisitions

Acquisition of Hightail, Inc.

On February 14, 2018, we acquired all of the equity interest in Hightail, a leading cloud service provider for file sharing and creative collaboration, for approximately $20.5 million. In accordance with ASC Topic 805 "Business Combinations" (Topic 805), this acquisition was accounted for as a business combination. We believe this acquisition complements and extends our Enterprise Information Management (EIM) portfolio.

The results of operations of this acquisition have been consolidated with those of OpenText beginning February 14, 2018.

Preliminary Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their preliminary fair values as of February 14, 2018, are set forth below:

Current assets	$1,327
Non-current tangible assets	1,265
Intangible customer assets	12,900
Intangible technology assets	4,200
Liabilities assumed	(6,353)
Total identifiable net assets	13,339
Goodwill	7,127
Net assets acquired	$20,466

The goodwill of $7.1 million is primarily attributable to the synergies expected to arise after the acquisition. No portion of this goodwill is expected to be deductible for tax purposes.

Included in total identifiable net assets is acquired deferred revenue with a fair value of $5.2 million, which represents our estimate of the fair value of the contractual obligations assumed based on a preliminary valuation. In arriving at this fair value, we reduced the acquired company’s original carrying value by $2.0 million.

The fair value of current assets acquired includes accounts receivable with a fair value of $0.7 million. The gross amount receivable was $0.8 million of which $0.1 million of this receivable is expected to be uncollectible.

Acquisition-related costs for Hightail included in "Special charges (recoveries)" in the Condensed Consolidated Financial Statements for the three and nine months ended March 31, 2018 was $0.5 million, respectively.

The acquisition had no significant impact on revenues and net earnings for the three and nine months ended March 31, 2018 since the date of acquisition.

Pro forma results of operations for this acquisition have not been presented because they are not material to the consolidated results of operations.

The finalization of the purchase price allocation is pending the finalization of the valuation of fair value for assets acquired and liabilities assumed, including tax balances. We expect to finalize this determination on or before December 31, 2018.

Acquisition of Guidance Software, Inc.

On September 14, 2017, we acquired all of the equity interest in Guidance, a leading provider of forensic security solutions, for approximately $240.5 million. In accordance with Topic 805, this acquisition was accounted for as a business combination. We believe this acquisition complements and extends our EIM portfolio.

The results of operations of this acquisition have been consolidated with those of OpenText beginning September 14, 2017.

The following tables summarize the preliminary consideration paid for Guidance and the amount of the assets acquired and liabilities assumed, as well as the goodwill recorded as of the acquisition date:

Cash consideration*	$237,291
Guidance shares already owned by OpenText through open market purchases (at fair value)	3,247
Preliminary purchase consideration	$240,538

* Inclusive of $2.3 million accrued for but unpaid as of March 31, 2018. See "Appraisal Proceedings" below for more information.

Preliminary Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their preliminary fair values as of September 14, 2017, are set forth below:

Current assets (inclusive of cash acquired of $5.7 million)	$25,253
Non-current tangible assets	10,540
Intangible customer assets	71,230
Intangible technology assets	51,851
Liabilities assumed	(48,670)
Total identifiable net assets	110,204
Goodwill	130,334
Net assets acquired	$240,538

The goodwill of $130.3 million is primarily attributable to the synergies expected to arise after the acquisition. Of this goodwill, approximately $1.9 million is expected to be deductible for tax purposes.

Included in total identifiable net assets is acquired deferred revenue with a fair value of $26.6 million, which represents our estimate of the fair value of the contractual obligations assumed based on a preliminary valuation. In arriving at this fair value, we reduced the acquired company's original carrying value by $7.6 million.

The fair value of current assets acquired includes accounts receivable with a fair value of $10.3 million. The gross amount receivable was $11.8 million of which $1.5 million of this receivable is expected to be uncollectible.

An amount of $0.8 million, representing the mark to market gain on the shares we held in Guidance prior to the acquisition, was recorded to "Other income" in our Condensed Consolidated Statements of Income for the nine months ended March 31, 2018.

Acquisition-related costs for Guidance included in "Special charges (recoveries)" in the Condensed Consolidated Financial Statements for the three and nine months ended March 31, 2018 were $0.4 million and $2.7 million, respectively.

The acquisition had no significant impact on revenues and net earnings for the three and nine months ended March 31, 2018 since the date of acquisition.

Pro forma results of operations for this acquisition have not been presented because they are not material to the consolidated results of operations.

The finalization of the purchase price allocation is pending the finalization of the valuation of fair value for assets acquired and liabilities assumed, including tax balances. We expect to finalize this determination on or before September 30, 2018.

Appraisal Proceedings

Under Section 262 of the Delaware General Corporation Law, shareholders who did not tender their shares in connection with our tender offer were entitled to have their shares appraised by the Delaware Court of Chancery and receive payment of the “fair value” of such shares. On August 31, 2017 we received notice from the record holder of approximately 1,519,569 shares or 5% of the issued and outstanding Guidance shares as of the date of acquisition, demanding an appraisal of the fair value of Guidance shares as they believed the price we paid for Guidance shares was less than its fair value. We accrued $10.8 million in connection with these claims, which is equivalent to paying $7.10 per Guidance share, the amount these Guidance shareholders otherwise would have received had they tendered their shares in our offer. During the second quarter of Fiscal 2018, we paid $8.5 million to the trust account of dissenting shareholders’ attorney, leaving $2.3 million accrued and unpaid for this matter. The amount accrued has been included within "Accounts payable and accrued liabilities" in the Condensed Consolidated Balance Sheets, with no impact to our Condensed Consolidated Statements of Income provided the courts rule within the open measurement period of 12 months from acquisition date.

Acquisition of Covisint Corporation

On July 26, 2017, we acquired all of the equity interest in Covisint, a leading cloud platform for building Identity, Automotive, and Internet of Things applications, for approximately $102.8 million. In accordance with Topic 805, this acquisition was accounted for as a business combination. We believe this acquisition complements and extends our EIM portfolio.

The results of operations of this acquisition have been consolidated with those of OpenText beginning July 26, 2017.

Preliminary Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their preliminary fair values as of July 26, 2017, are set forth below:

Current assets (inclusive of cash acquired of $31.5 million)	$41,586
Non-current tangible assets	3,426
Intangible customer assets	36,600
Intangible technology assets	17,300
Liabilities assumed	(23,033)
Total identifiable net assets	75,879
Goodwill	26,905
Net assets acquired	$102,784

The goodwill of $26.9 million is primarily attributable to the synergies expected to arise after the acquisition. Of this goodwill, approximately $26.8 million is expected to be deductible for tax purposes.

Included in total identifiable net assets is acquired deferred revenue with a fair value of $12.2 million, which represents our estimate of the fair value of the contractual obligations assumed based on a preliminary valuation. In arriving at this fair value, we reduced the acquired company’s original carrying value by $4.6 million.

The fair value of current assets acquired includes accounts receivable with a fair value of $7.8 million. The gross amount receivable was $7.9 million of which $0.1 million of this receivable is expected to be uncollectible.

Acquisition-related costs for Covisint included in "Special charges (recoveries)" in the Condensed Consolidated Financial Statements for the three and nine months ended March 31, 2018 were nil and $0.9 million, respectively.

The acquisition had no significant impact on revenues and net earnings for the three and nine months ended March 31, 2018 since the date of acquisition.

Pro forma results of operations for this acquisition have not been presented because they are not material to the consolidated results of operations.

The finalization of the purchase price allocation is pending the finalization of the valuation of fair value for assets acquired and liabilities assumed, including tax balances. We expect to finalize this determination on or before June 30, 2018.

Fiscal 2017 Acquisitions

Purchase of an Asset Group Constituting a Business - ECD Business

On January 23, 2017, we acquired certain assets and assumed certain liabilities of the enterprise content division of EMC Corporation, a Massachusetts corporation, and certain of its subsidiaries, collectively referred to as Dell-EMC (ECD Business) for approximately $1.62 billion. In accordance with Topic 805, this acquisition was accounted for as a business combination. ECD Business offers OpenText a suite of leading Enterprise Content Management solutions with deep industry focus, including the Documentum™, InfoArchive™, and LEAP™ product families. We believe this acquisition complements and extends our EIM portfolio.

The results of operations of this acquisition were consolidated with those of OpenText beginning January 23, 2017.

Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their fair values as of January 23, 2017, are set forth below:

Current assets	$11,339
Non-current tangible assets	103,672
Intangible customer assets	407,000
Intangible technology assets	459,000
Liabilities assumed	(182,301)
Total identifiable net assets	798,710
Goodwill	823,684
Net assets acquired	$1,622,394

The goodwill of $823.7 million is primarily attributable to the synergies expected to arise after the acquisition. Of this goodwill, approximately $378.5 million is expected to be deductible for tax purposes.

Included in total identifiable net assets is acquired deferred revenue with a fair value of $163.8 million, which represents our estimate of the fair value of the contractual obligations assumed. In arriving at this fair value, we reduced the acquired company's original carrying value by $52.0 million.

Further, included within total identifiable net assets are also certain contract assets which represent revenue earned by the ECD Business on long-term projects for which billings had not yet occurred as of January 23, 2017. As these long-term projects have now been inherited by OpenText, we are responsible for billing and collecting cash on these projects at the appropriate time, yet we do not and will not recognize revenue for these billings. The fair value assigned to these contract assets as of January 23, 2017 was $8.4 million.

Purchase of an Asset Group Constituting a Business - CCM Business

On July 31, 2016, we acquired certain customer communications management software and services assets and liabilities from HP Inc. (CCM Business) for approximately $315.0 million. In accordance with Topic 805, this acquisition was accounted for as a business combination. We believe this acquisition complements our current software portfolio, and allows us to better serve our customers by offering a wider set of CCM capabilities.

The results of operations of this acquisition were consolidated with those of OpenText beginning July 31, 2016.

Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their fair values as of July 31, 2016, are set forth below:

Current assets	$683
Non-current deferred tax asset	11,861
Non-current tangible assets	2,348
Intangible customer assets	64,000
Intangible technology assets	101,000
Liabilities assumed	(38,090)
Total identifiable net assets	141,802
Goodwill	173,198
Net assets acquired	$315,000

The goodwill of $173.2 million is primarily attributable to the synergies expected to arise after the acquisition. Of this goodwill, approximately $105.1 million is expected to be deductible for tax purposes.

Acquisition of Recommind, Inc.

On July 20, 2016, we acquired all of the equity interest in Recommind, Inc. (Recommind), a leading provider of eDiscovery and information analytics, for approximately $170.1 million. In accordance with Topic 805, this acquisition was accounted for as a business combination. We believe this acquisition complements our EIM solutions, and through eDiscovery and analytics, provides increased visibility into structured and unstructured data.

The results of operations of Recommind, were consolidated with those of OpenText beginning July 20, 2016.

Purchase Price Allocation

The recognized amounts of identifiable assets acquired and liabilities assumed, based upon their fair values as of July 20, 2016, are set forth below:

Current assets	$30,034
Non-current tangible assets	1,245
Intangible customer assets	51,900
Intangible technology assets	24,800
Long-term deferred tax liabilities	(1,780)
Other liabilities assumed	(27,497)
Total identifiable net assets	78,702
Goodwill	91,405
Net assets acquired	$170,107

The goodwill of $91.4 million is primarily attributable to the synergies expected to arise after the acquisition. No portion of this goodwill is expected to be deductible for tax purposes.

The fair value of current assets acquired includes accounts receivable with a fair value of $28.7 million. The gross amount receivable was $29.6 million of which $0.9 million of this receivable was expected to be uncollectible.

NOTE 19—SUPPLEMENTAL CASH FLOW DISCLOSURES

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
Cash paid during the period for interest	$32,489	$29,889	$97,353	$83,474
Cash received during the period for interest	$332	$1,164	$873	$2,634
Cash paid during the period for income taxes	$23,654	$21,146	$52,488	$60,828

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NOTE 20—EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income, attributable to OpenText, by the weighted average number of Common Shares outstanding during the period. Diluted earnings per share are computed by dividing net income, attributable to OpenText, by the shares used in the calculation of basic earnings per share plus the dilutive effect of Common Share equivalents, such as stock options, using the treasury stock method. Common Share equivalents are excluded from the computation of diluted earnings per share if their effect is anti-dilutive.

	Three Months Ended March 31,		Nine Months Ended March 31,		
	2018	2017	2018	2017	
Basic earnings per share					
Net income attributable to OpenText	$58,794	$21,616	$180,501	$979,522	(1)
Basic earnings per share attributable to OpenText	$0.22	$0.08	$0.68	$3.91	
Diluted earnings per share					
Net income attributable to OpenText	$58,794	$21,616	$180,501	$979,522	(1)
Diluted earnings per share attributable to OpenText	$0.22	$0.08	$0.68	$3.88	
Weighted-average number of shares outstanding					
Basic	266,572	263,329	265,619	250,538	
Effect of dilutive securities	1,192	2,111	1,335	1,931	
Diluted	267,764	265,440	266,954	252,469	
Excluded as anti-dilutive[(2)]	2,102	1,117	2,690	1,577	

[(1)] Please also see note 14 "Income Taxes" for details relating to a one-time tax benefit of $876.1 million recorded during the three months ended September 30, 2016 in connection with an internal reorganization of our subsidiaries.

[(2)] Represents options to purchase Common Shares excluded from the calculation of diluted earnings per share because the exercise price of the stock options was greater than or equal to the average price of the Common Shares during the period.

NOTE 21—RELATED PARTY TRANSACTIONS

Our procedure regarding the approval of any related party transaction requires that the material facts of such transaction be reviewed by the independent members of the Audit Committee and the transaction be approved by a majority of the independent members of the Audit Committee. The Audit Committee reviews all transactions in which we are, or will be, a participant and any related party has or will have a direct or indirect interest in the transaction. In determining whether to approve a related party transaction, the Audit Committee generally takes into account, among other facts it deems appropriate, whether the transaction is on terms no less favorable than terms generally available to an unaffiliated third party under the same or similar circumstances; the extent and nature of the related person’s interest in the transaction; the benefits to the Company of the proposed transaction; if applicable, the effects on a director’s independence; and if applicable, the availability of other sources of comparable services or products.

During the nine months ended March 31, 2018, Mr. Stephen Sadler, a director, earned $0.8 million (nine months ended March 31, 2017—$0.8 million) in consulting fees from OpenText for assistance with acquisition-related business activities. Mr. Sadler abstained from voting on all transactions from which he would potentially derive consulting fees.

NOTE 22—SUBSEQUENT EVENT

Cash Dividends

As part of our quarterly, non-cumulative cash dividend program, we declared, on May 8, 2018, a dividend of $0.1518 per Common Share. The record date for this dividend is June 8, 2018 and the payment date is June 29, 2018. Future declarations of dividends and the establishment of future record and payment dates are subject to the final determination and discretion of our Board.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 21E of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 27A of the U.S. Securities Act of 1933, as amended (the Securities Act), and is subject to the safe harbors created by those sections. All statements other than statements of historical facts are statements that could be deemed forward-looking statements.
When used in this report, the words “anticipates”, “expects”, “intends”, “plans”, “believes”, “seeks”, “estimates”, “may”, “coul "might", "will" and other similar language, as they relate to Open Text Corporation (“OpenText” or the “Company”), are intended to identify forward-looking statements under applicable securities laws. Specific forward-looking statements in this report include, but are not limited to: (i) statements about our focus in the fiscal year beginning July 1, 2017 and ending June 30, 2018 (Fiscal 2018) on growth in earnings and cash flows; (ii) creating value through investments in broader Enterprise Information Management (EIM) capabilities; (iii) our future business plans and business planning process; (iv) statements relating to business trends; (v) statements relating to distribution; (vi) the Company’s presence in the cloud and in growth markets; (vii) product and solution developments, enhancements and releases and the timing thereof; (viii) the Company’s financial conditions, results of operations and earnings; (ix) the basis for any future growth and for our financial performance; (x) declaration of quarterly dividends; (xi) future tax rates; (xii) the changing regulatory environment including the new tax reform legislation enacted through the Tax Cuts and Jobs Act in the United States and its impact on our business; (xiii) annual recurring revenues; (xiv) research and development and related expenditures; (xv) our building, development and consolidation of our network infrastructure; (xvi) competition and changes in the competitive landscape; (xvii) our management and protection of intellectual property and other proprietary rights; (xviii) foreign sales and exchange rate fluctuations; (xix) cyclical or seasonal aspects of our business; (xx) capital expenditures; (xxi) potential legal and/or regulatory proceedings; (xxii) statements about the impact of OpenText Magellan and OpenText Release 16; and (xxiii) other matters.
In addition, any statements or information that refer to expectations, beliefs, plans, projections, objectives, performance or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking, and based on our current expectations, forecasts and projections about the operating environment, economies and markets in which we operate. Forward-looking statements reflect our current estimates, beliefs and assumptions, which are based on management’s perception of historic trends, current conditions and expected future developments, as well as other factors it believes are appropriate in the circumstances. The forward-looking statements contained in this report are based on certain assumptions including the following: (i) countries continuing to implement and enforce existing and additional customs and security regulations relating to the provision of electronic information for imports and exports; (ii) our continued operation of a secure and reliable business network; (iii) the stability of general economic and market conditions, currency exchange rates, and interest rates; (iv) equity and debt markets continuing to provide us with access to capital; (v) our continued ability to identify, source and finance attractive and executable business combination opportunities; and (vi) our continued compliance with third party intellectual property rights. Management’s estimates, beliefs and assumptions are inherently subject to significant business, economic, competitive and other uncertainties and contingencies regarding future events and, as such, are subject to change. We can give no assurance that such estimates, beliefs and assumptions will prove to be correct.
Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to differ materially from the anticipated results, performance or achievements expressed or implied by such forward-looking statements. The risks and uncertainties that may affect forward-looking statements include, but are not limited to: (i) integration of acquisitions and related restructuring efforts, including the quantum of restructuring charges and the timing thereof; (ii) the potential for the incurrence of or assumption of debt in connection with acquisitions and the impact on the ratings or outlooks of rating agencies on our outstanding debt securities; (iii) the possibility that the Company may be unable to meet its future reporting requirements under the Exchange Act, and the rules promulgated thereunder, or applicable Canadian securities regulation; (iv) the risks associated with bringing new products and services to market; (v) fluctuations in currency exchange rates (including as a result of the impact of Brexit and any policy changes resulting from the new U.S. administration); (vi) delays in the purchasing decisions of the Company’s customers; (vii) the competition the

Company faces in its industry and/or marketplace; (viii) the final determination of litigation, tax audits (including tax examinations in the United States, Canada or elsewhere) and other legal proceedings; (ix) potential exposure to greater than anticipated tax liabilities or expenses, including with respect to changes in Canadian, U.S. or international tax regimes; (x) the possibility of technical, logistical or planning issues in connection with the deployment of the Company's products or services; (xi) the continuous commitment of the Company's customers; (xii) demand for the Company's products and services; (xiii) increase in exposure to international business risks (including as a result of the impact of Brexit and any policy changes resulting from the new U.S. administration) as we continue to increase our international operations; (xiv) inability to raise capital at all or on not unfavorable terms in the future; (xv) downward pressure on our share price and dilutive effect of future sales or issuances of equity securities (including in connection with future acquisitions); and (xvi) potential changes in ratings or outlooks of rating agencies on our outstanding debt securities. Other factors that may affect forward-looking statements include, but are not limited to: (i) the future performance, financial and otherwise, of the Company; (ii) the ability of the Company to bring new products and services to market and to

increase sales; (iii) the strength of the Company's product development pipeline; (iv) failure to secure and protect patents, trademarks and other proprietary rights; (v) infringement of third-party proprietary rights triggering indemnification obligations and resulting in significant expenses or restrictions on our ability to provide our products or services; (vi) failure to comply with privacy laws and regulations that are extensive, open to various interpretations and complex to implement including General Data Protection Regulation (GDPR); (vii) the Company's growth and other profitability prospects; (viii) the estimated size and growth prospects of the EIM market; (ix) the Company's competitive position in the EIM market and its ability to take advantage of future opportunities in this market; (x) the benefits of the Company's products and services to be realized by customers; (xi) the demand for the Company's products and services and the extent of deployment of the Company's products and services in the EIM marketplace; (xii) the Company's financial condition and capital requirements; (xiii) system or network failures or information security breaches in connection with the Company's offerings and information technology systems generally; and (xiv) failure to attract and retain key personnel to develop and effectively manage the Company's business.
For additional information with respect to risks and other factors which could occur, see Part II, Item 1A "Risk Factors" herein and the Company's Annual Report on Form 10-K, including Part I, Item 1A "Risk Factors" therein; Quarterly Reports on Form 10-Q, including Item 1A herein and other documents we file from time to time with the Securities and Exchange Commission (SEC) and other securities regulators. Readers are cautioned not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. Unless otherwise required by applicable securities laws, the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.
The following MD&A is intended to help readers understand our results of operations and financial condition, and is provided as a supplement to, and should be read in conjunction with, our Condensed Consolidated Financial Statements and the accompanying Notes to our Condensed Consolidated Financial Statements under Part I, Item 1 of this Quarterly Report on Form 10-Q.
All dollar and percentage comparisons made herein generally refer to the three and nine months ended March 31, 2018 compared with the three and nine months ended March 31, 2017, unless otherwise noted.
Where we say "we", "us", "our", "OpenText" or "the Company", we mean Open Text Corporation or Open Text Corporation a its subsidiaries, as applicable.

EXECUTIVE OVERVIEW

We operate in the EIM market. We develop enterprise software for digital transformation. OpenText's comprehensive platform and suite of software products and services provide secure and scalable solutions for global companies. Our software assists organizations with finding, utilizing and sharing business information from any device in ways that are intuitive, efficient and productive. We also help ensure that information remains secure and private, as demanded in today's highly regulated climate. In addition, we provide solutions that facilitate the exchange of information and transactions between supply chain participants, such as manufacturers, retailers, distributors and financial institutions. These are central to a company's ability to collaborate effectively with its partners. Our focus is to help customers automate processes. The algorithms embedded in our software aim to enable customers to unlock massive amounts of data and gain better insight into their business, which ultimately can lead to better decision making.
We offer software through traditional on-premise solutions, cloud solutions or a combination of both on-premise and cloud solutions (hybrid). We are agnostic as to which delivery method a customer prefers. We believe giving customers choice and flexibility will help us to strive to obtain long-term customer value.
Our initial public offering was on the NASDAQ in 1996 and we were subsequently listed on the Toronto Stock Exchange (TSX) in 1998. We are a multinational company and as of March 31, 2018, employed approximately 12,200 people worldwide.
Our ticker symbol on both the NASDAQ and the TSX is "OTEX".
Quarterly Summary:
During the quarter we saw the following activity:

- Total revenue was $685.9 million, up 15.6% compared to the same period in the prior fiscal year; up 10.8% after factoring the impact of $28.7 million of foreign exchange rate changes.
- Total annual recurring revenue, which we define as the sum of cloud services and subscriptions revenue and customer support revenue, was $521.4 million, up 18.3% compared to the same period in the prior fiscal year; up 13.9% after

factoring the impact of $19.5 million of foreign exchange rate changes.

- Cloud services and subscriptions revenue was $209.1 million, up 18.1% compared to the same period in the prior fiscal year; up 15.2% after factoring the impact of $5.1 million of foreign exchange rate changes.

- License revenue was $84.1 million, down 3.6% compared to the same period in the prior fiscal year; down 8.3% after factoring the impact of $4.2 million of foreign exchange rate changes.
- GAAP-based EPS, diluted, was $0.22 compared to $0.08 in the same period in the prior fiscal year.
- Non-GAAP-based EPS, diluted, was $0.54 compared to $0.45 in the same period in the prior fiscal year.
- GAAP-based gross margin was 64.6% compared to 64.5% in the same period in the prior fiscal year.
- Non-GAAP-based gross margin was 71.6% compared to 71.2% in the same period in the prior fiscal year.
- GAAP-based operating margin was 14.9% compared to 11.0% in the same period in the prior fiscal year.
- Non-GAAP-based operating margin was 29.8% compared to 29.1% in the same period in the prior fiscal year.
- GAAP-based net income attributable to OpenText was $58.8 million compared to $21.6 million in the same period in the prior fiscal year.
- Non-GAAP-based net income attributable to OpenText was $145.8 million compared to $119.8 million in the same period in the prior fiscal year.
- Adjusted EBITDA was $227.2 million compared to $189.1 million in the same period in the prior fiscal year.
- Operating cash flow was $504.4 million for the nine months ended March 31, 2018, up 49.8% from the same period in the prior fiscal year.
- Cash and cash equivalents was $605.5 million as of March 31, 2018, compared to $443.4 million as of June 30, 2017.

See "Use of Non-GAAP Financial Measures" below for definitions and reconciliations of GAAP-based measures to Non-GAAP-based measures.

See "Acquisitions" below for the impact of acquisitions on the period-to-period comparability of results.

Acquisitions

Our competitive position in the marketplace requires us to maintain a complex and evolving array of technologies, products, services and capabilities. In light of the continually evolving marketplace in which we operate, on an ongoing basis we regularly evaluate acquisition opportunities within the EIM market and at any time may be in various stages of discussions with respect to such opportunities.

Acquisition of Hightail, Inc.

On February 14, 2018, we acquired all of the equity interest in Hightail, Inc. (Hightail), a leading cloud service provider for file sharing and creative collaboration, for approximately $20.5 million. This acquisition complements and extends our EIM portfolio. The results of operations of this acquisition have been consolidated with those of OpenText beginning February 14, 2018.

Acquisition of Guidance Software, Inc.

On September 14, 2017, we acquired all of the equity interest in Guidance Software Inc. (Guidance), a leading provider of forensic security solutions, for approximately $240.5 million. This acquisition complements and extends our EIM portfolio. The results of operations of this acquisition have been consolidated with those of OpenText beginning September 14, 2017.

Acquisition of Covisint Corporation

On July 26, 2017, we acquired all of the equity interest in Covisint Corporation (Covisint), a leading cloud platform for building Identity, Automotive, and Internet of Things applications, for approximately $102.8 million. This acquisition complements and extends our EIM portfolio. The results of operations of this acquisition have been consolidated with those of OpenText beginning July 26, 2017.

We believe our acquisitions support our long-term strategic direction, strengthen our competitive position, expand our customer base, provide greater scale to accelerate innovation, grow our earnings and provide superior shareholder value. We expect to continue to strategically acquire companies, products, services and technologies to augment our existing business. Our acquisitions, particularly significant ones, can affect the period-to-period comparability of our results. See note 18 "Acquisitions" to our Condensed Consolidated Financial Statements for more details.

Outlook for remainder of Fiscal 2018

We expect to continue to pursue strategic acquisitions in the future to strengthen our service offerings in the EIM market, and at any time may be in various stages of discussions with respect to such opportunities. We believe we are a value oriented and disciplined acquirer, having efficiently deployed approximately $5.8 billion on acquisitions over the last 10 years. We see

our ability to successfully integrate acquired companies and assets into our business as a strength and pursuing strategic acquisitions is an important aspect to our growth strategy. During Fiscal 2018, we further demonstrated the implementation of this strategy by acquiring Covisint, Guidance and Hightail, deploying an aggregate of $363.8 million.

While continuing to acquire companies is our leading growth driver, our growth strategy also includes organic growth through internal innovation. This quarter we invested approximately $84 million in research and development (R&D) or approximately 12% of revenue, in line with our target to spend approximately 11% to 13% of revenues for R&D this fiscal year. We believe our ability to leverage our global presence is helpful to our organic growth initiatives.

We have developed an Artificial Intelligence (AI) platform called “OpenText Magellan” (Magellan). Our approach to AI is via an open source code and we believe in making long-term, strategic investments to developing AI. As our enterprise software has historically been focused on managing data and content archives, we believe we are well positioned to turn these archives of data into active “data lakes” and we believe we can develop AI to transform this digital information into useful knowledge and insight for our customers.

We see an opportunity to help our customers become “digital businesses” and, with Magellan and OpenText Release 16 as well as our recent acquisitions, we believe we have a strong platform to integrate personalized analytics and insights onto our OpenText EIM suites of products, which will further our vision to enable “the digital world” and strengthen our position among leaders in EIM.

CRITICAL ACCOUNTING POLICIES AND 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 Condensed 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 materially from those estimates. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

(i) Revenue recognition,
(ii) Capitalized software,
(iii) Business combinations,
(iv) Goodwill,
(v) Acquired intangibles,
(vi) Restructuring charges,
(vii) Foreign currency, and
(viii) Income taxes.

During the third quarter of Fiscal 2018, there were no significant changes to our critical accounting policies and estimates. However, income tax estimates were impacted by the Tax Cuts and Jobs Act which was enacted in the United States on December 22, 2017. The Company has recorded a provisional charge and continues to assess the effect of the new law on its Condensed Consolidated Financial Statements in accordance with Staff Accounting Bulletin 118 “Income Tax Accounting Implications of the Tax Cuts and Jobs Act” (SAB 118). For more details related to this matter, please refer to note 14 "Income Taxes" to our Condensed Consolidated Financial Statements.

Furthermore, for a detailed discussion of our critical accounting and estimates, please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended June 30, 2017.

RESULTS OF OPERATIONS

The following tables provide a detailed analysis of our results of operations and financial condition. For each of the periods indicated below, we present our revenues by product, revenues by major geography, cost of revenues by product, total gross margin, total operating margin, gross margin by product, and their corresponding percentage of total revenue. In addition, we provide Non-GAAP measures for the periods discussed in order to provide additional information to investors that we believe will be useful as this presentation is in line with how our management

assesses our Company's performance. See "Use of Non-GAAP Financial Measures" below for a reconciliation of GAAP-based measures to Non-GAAP-based measures.

Summary of Results of Operations

(In thousands)	Three Months Ended March 31, 2018	Change increase (decrease)	2017	Nine Months Ended March 31, 2018	Change increase (decrease)	2017
Total Revenues by Product Type:						
License	$84,113	$(3,114)	$87,227	$297,588	$51,941	$245,647
Cloud services and subscriptions	209,102	31,993	177,109	611,076	89,219	521,857
Customer support	312,279	48,843	263,436	915,753	222,455	693,298
Professional service and other	80,385	15,027	65,358	236,554	69,853	166,701
Total revenues	685,879	92,749	593,130	2,060,971	433,468	1,627,503
Total Cost of Revenues	242,731	32,242	210,489	706,543	163,668	542,875
Total GAAP-based Gross Profit	443,148	60,507	382,641	1,354,428	269,800	1,084,628
Total GAAP-based Gross Margin %	64.6 %		64.5 %	65.7 %		66.6 %
Total GAAP-based Operating Expenses	340,825	23,445	317,380	998,374	160,226	838,148
Total GAAP-based Income from Operations	$102,323	$37,062	$65,261	$356,054	$109,574	$246,480
% Revenues by Product Type:						
License	12.3 %		14.7 %	14.5 %		15.1 %
Cloud services and subscriptions	30.5 %		29.9 %	29.6 %		32.1 %
Customer support	45.5 %		44.4 %	44.4 %		42.6 %
Professional service and other	11.7 %		11.0 %	11.5 %		10.2 %
Total Cost of Revenues by Product Type:						
License	$3,098	$(910)	$4,008	$10,645	$401	$10,244
Cloud services and subscriptions	94,264	17,039	77,225	269,012	48,345	220,667
Customer support	33,820	(622)	34,442	99,805	12,276	87,529
Professional service and other	64,246	8,717	55,529	188,690	51,523	137,167
Amortization of acquired technology-based intangible assets	47,303	8,018	39,285	138,391	51,123	87,268
Total cost of revenues	$242,731	$32,242	$210,489	$706,543	$163,668	$542,875
% GAAP-based Gross Margin by Product Type:						
License	96.3 %		95.4 %	96.4 %		95.8 %
Cloud services and subscriptions	54.9 %		56.4 %	56.0 %		57.7 %
Customer support	89.2 %		86.9 %	89.1 %		87.4 %
Professional service and other	20.1 %		15.0 %	20.2 %		17.7 %
Total Revenues by Geography:(1)						
Americas (2)	$395,453	$51,545	$343,908	$1,191,579	$234,471	$957,108
EMEA (3)	222,565	26,984	195,581	662,403	142,917	519,486
Asia Pacific (4)	67,861	14,220	53,641	206,989	56,080	150,909
Total revenues	$685,879	$92,749	$593,130	$2,060,971	$433,468	$1,627,503
% Revenues by Geography:						
Americas (2)	57.7 %		58.0 %	57.8 %		58.8 %

EMEA [3]	32.4	%	33.0	%	32.1	%	31.9	%
Asia Pacific [4]	9.9	%	9.0	%	10.1	%	9.3	%

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2018	2017	2018	2017
GAAP-based gross margin	64.6 %	64.5 %	65.7 %	66.6 %
GAAP-based operating margin	14.9 %	11.0 %	17.3 %	15.1 %
GAAP-based EPS, diluted	$0.22	$0.08	$0.68	$3.88 (6)
Net income, attributable to OpenText	$58,794	$21,616	$180,501	$979,522 (6)
Non-GAAP-based gross margin (5)	71.6 %	71.2 %	72.6 %	72.2 %
Non-GAAP-based operating margin (5)	29.8 %	29.1 %	32.7 %	31.2 %
Non-GAAP-based EPS, diluted (5)	$0.54	$0.45	$1.84	$1.42
Adjusted EBITDA (5)	$227,199	$189,079	$737,263	$555,519

(1) Total revenues by geography are determined based on the location of our end customer.
(2) Americas consists of countries in North, Central and South America.
(3) EMEA primarily consists of countries in Europe, the Middle East and Africa.
(4) Asia Pacific primarily consists of the countries Japan, Australia, China, Korea, Philippines, Singapore and New Zealand.
(5) See "Use of Non-GAAP Financial Measures" (discussed later in the MD&A) for definitions and reconciliations of GAAP-based measures to Non-GAAP-based measures.
(6) We recorded a significant tax benefit in the first quarter of Fiscal 2017 of $876.1 million. This significant tax benefit is specifically tied to the Company's internal reorganization and applied to the first quarter of Fiscal 2017 only and as a result, has not and will not continue in future periods.

Revenues, Cost of Revenues and Gross Margin by Product Type

1) License:

License revenues consist of fees earned from the licensing of software products to customers. Our license revenues are impacted by the strength of general economic and industry conditions, the competitive strength of our software products, and our acquisitions. Cost of license revenues consists primarily of royalties payable to third parties.

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
License Revenues:						
Americas	$37,984	$ (1,263)	$39,247	$139,539	$ 21,717	$117,822
EMEA	29,971	(8,344)	38,315	110,150	9,517	100,633
Asia Pacific	16,158	6,493	9,665	47,899	20,707	27,192
Total License Revenues	84,113	(3,114)	87,227	297,588	51,941	245,647
Cost of License Revenues	3,098	(910)	4,008	10,645	401	10,244
GAAP-based License Gross Profit	$81,015	$ (2,204)	$83,219	$286,943	$ 51,540	$235,403
GAAP-based License Gross Margin %	96.3 %		95.4 %	96.4 %		95.8 %
% License Revenues by Geography:						
Americas	45.2 %		45.0 %	46.9 %		48.0 %
EMEA	35.6 %		43.9 %	37.0 %		41.0 %
Asia Pacific	19.2 %		11.1 %	16.1 %		11.0 %

License revenues decreased by $3.1 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $4.2 million. Geographically, the overall decrease was attributable to a decrease in EMEA of $8.3 million and a decrease in Americas of $1.3 million, partially offset by an increase in Asia Pacific of $6.5 million. The number of license deals greater than $0.5 million that closed during the third quarter of Fiscal 2018 was 25 deals, of which 12 deals were greater than $1.0 million, compared to 18 deals in the third quarter of Fiscal 2017, of which 7 deals were greater than $1.0 million. Although we closed more deals during the current period, the average size of such deals was lower than

those closed during the same period in the prior fiscal year.

License revenues increased by $51.9 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $9.8 million. Geographically, the overall increase was attributable to an increase in Americas of $21.7 million, an increase in Asia Pacific of $20.7 million and an increase in EMEA of $9.5 million. During the current fiscal year, we have closed 88 license deals greater than $0.5 million, of which 35 deals were greater than $1.0 million. This is compared to 82 deals in the same period in Fiscal 2017, of which 31 deals were greater than $1.0 million. The increase in license deals have contributed to higher license revenues in the current fiscal year.

Cost of license revenues decreased by $0.9 million during the three months ended March 31, 2018, as compared to the same period in the prior fiscal year due to a decrease in royalties payable to third parties. Overall, the gross margin percentage on license revenues remained stable at approximately 96%.

Cost of license revenues increased by $0.4 million during the nine months ended March 31, 2018, as compared to the same period in the prior fiscal year due to an increase in royalties payable to third parties. Overall, the gross margin percentage on license revenues remained stable at approximately 96%.

2) Cloud Services and Subscriptions:

Cloud services and subscription revenues consist of (i) software as a service offerings, (ii) managed service arrangements and (iii) subscription revenues relating to on premise offerings. These offerings allow our customers to make use of OpenText software, services and content over Internet enabled networks supported by OpenText data centers. These web applications allow customers to transmit a variety of content between various mediums and to securely manage enterprise information without the commitment of investing in related hardware infrastructure. Revenues are generated on several transactional usage-based models, are typically billed monthly in arrears, and can therefore fluctuate from period to period. Certain service fees are occasionally charged to customize hosted software for some customers and are either amortized over the estimated customer life, in the case of setup fees, or recognized in the period they are provided.

In addition, we offer business-to-business (B2B) integration solutions, such as messaging services, and managed services. Messaging services allow for the automated and reliable exchange of electronic transaction information, such as purchase orders, invoices, shipment notices and other business documents, among businesses worldwide. Managed services provide an end-to-end fully outsourced B2B integration solution to our customers, including program implementation, operational management, and customer support. These services enable customers to effectively manage the flow of electronic transaction information with their trading partners and reduce the complexity of disparate standards and communication protocols. Revenues are primarily generated through transaction processing. Transaction processing fees are recurring in nature and are recognized on a per transaction basis in the period in which the related transactions are processed. Revenues from contracts with monthly, quarterly or annual minimum transaction levels are recognized based on the greater of the actual transactions or the specified contract minimum amounts during the relevant period. Customers who are not committed to multi-year contracts generally are under contracts for transaction processing solutions that automatically renew every month or year, depending on the terms of the specific contracts.

Cost of Cloud services and subscriptions revenues is comprised primarily of third party network usage fees, maintenance of in-house data hardware centers, technical support personnel-related costs, amortization of customer set up and implementation costs, and some third party royalty costs.

(In thousands)	Three Months Ended March 31, 2018	Change increase (decrease)	2017	Nine Months Ended March 31, 2018	Change increase (decrease)	2017
Cloud Services and Subscriptions:						
Americas	$142,246	$ 21,986	$120,260	$410,960	$ 56,352	$354,608
EMEA	47,652	8,271	39,381	139,907	23,664	116,243
Asia Pacific	19,204	1,736	17,468	60,209	9,203	51,006
Total Cloud Services and Subscriptions Revenues	209,102	31,993	177,109	611,076	89,219	521,857
Cost of Cloud Services and Subscriptions Revenues	94,264	17,039	77,225	269,012	48,345	220,667
GAAP-based Cloud Services and Subscriptions Gross Profit	$114,838	$ 14,954	$99,884	$342,064	$ 40,874	$301,190
GAAP-based Cloud Services and Subscriptions Gross Margin %	54.9 %		56.4 %	56.0 %		57.7 %
% Cloud Services and Subscriptions Revenues by Geography:						
Americas	68.0 %		67.9 %	67.3 %		68.0 %
EMEA	22.8 %		22.2 %	22.9 %		22.3 %
Asia Pacific	9.2 %		9.9 %	9.8 %		9.7 %

Cloud services and subscriptions revenues increased by $32.0 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $5.1 million. Geographically, the overall change was attributable to an increase in Americas of $22.0 million, an increase in EMEA of $8.3 million and an increase in Asia Pacific of $1.7 million. The number of Cloud services deals greater than $1.0 million that closed during the third quarter of Fiscal 2018 was 10 deals, compared to 12 deals in the third quarter of Fiscal 2017.

Cloud services and subscriptions revenues increased by $89.2 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $5.0 million. Geographically, the overall change was attributable to an increase in Americas of $56.4 million, an increase in EMEA of $23.7 million and an increase in Asia Pacific of $9.2 million. The number of Cloud services deals greater than $1.0 million that closed during the first nine months of Fiscal 2018 was 31 deals, compared to 33 in the same period in Fiscal 2017.

Cost of Cloud services and subscriptions revenues increased by $17.0 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, primarily due to (i) an increase in labour-related costs of approximately $15.0 million, driven partly on account of recent acquisitions, (ii) an increase in third party network usage fees of $1.6 million and (iii) an increase in other miscellaneous costs of $0.4 million. Overall, the gross margin percentage on Cloud services and subscriptions revenues decreased slightly to approximately 55% from approximately 56%.

Cost of Cloud services and subscriptions revenues increased by $48.3 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, primarily due to (i) an increase in labour-related costs of approximately $46.5 million, predominantly on account of recent acquisitions, (ii) an increase in third party network usage fees of $1.6 million and (iii) an increase in other miscellaneous costs of $0.2 million. Overall, the gross margin percentage on Cloud services and subscriptions revenues decreased to approximately 56% from approximately 58%.

3) Customer Support:

Customer support revenues consist of revenues from our customer support and maintenance agreements. These agreements allow our customers to receive technical support, enhancements and upgrades to new versions of our software products when and if available. Customer support revenues are generated from support and maintenance relating to current year sales of software products and from the renewal of existing maintenance agreements for

software licenses sold in prior periods. Therefore, changes in Customer support revenues do not always correlate directly to the changes in license revenues from period to period. The terms of support and maintenance agreements are typically twelve months, with customer renewal options. Our management reviews our Customer support renewal rates on a quarterly basis and we use these rates as a method of monitoring our customer service performance. For the quarter ended March 31, 2018, our Customer support renewal rate was approximately 91%, stable compared with the Customer support renewal rate during the quarter ended March 31, 2017.
Cost of Customer support revenues is comprised primarily of technical support personnel and related costs, as well as third party royalty costs.

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(In thousands)	Three Months Ended March 31, 2018	Change increase (decrease)	2017	Nine Months Ended March 31, 2018	Change increase (decrease)	2017
Customer Support Revenues:						
Americas	$178,355	$24,853	$153,502	$527,961	$120,479	$407,482
EMEA	109,584	20,579	89,005	312,949	83,660	229,289
Asia Pacific	24,340	3,411	20,929	74,843	18,316	56,527
Total Customer Support Revenues	312,279	48,843	263,436	915,753	222,455	693,298
Cost of Customer Support Revenues	33,820	(622)	34,442	99,805	12,276	87,529
GAAP-based Customer Support Gross Profit	$278,459	$49,465	$228,994	$815,948	$210,179	$605,769
GAAP-based Customer Support Gross Margin %	89.2%		86.9%	89.1%		87.4%
% Customer Support Revenues by Geography:						
Americas	57.1%		58.3%	57.7%		58.8%
EMEA	35.1%		33.8%	34.2%		33.1%
Asia Pacific	7.8%		7.9%	8.1%		8.1%

Customer support revenues increased by $48.8 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $14.4 million. Geographically, the overall increase was attributable to an increase in Americas of $24.9 million, an increase in EMEA of $20.6 million and an increase in Asia Pacific of $3.4 million.

Customer support revenues increased by $222.5 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $24.4 million. Geographically, the overall increase was attributable to an increase in Americas of $120.5 million, an increase in EMEA of $83.7 million and an increase in Asia Pacific of $18.3 million.

Cost of Customer support revenues decreased by $0.6 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, due to a decrease in labour-related costs of approximately $0.5 million and a decrease in the installed base of third party products of approximately $0.2 million. These decreases were partially offset by an increase in other miscellaneous costs of $0.1 million. Overall, the gross margin percentage on Customer support revenues increased to approximately 89% from approximately 87%.

Cost of Customer support revenues increased by $12.3 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, due to (i) an increase in labour-related costs of approximately $10.7 million, which was predominantly due to recent acquisitions, (ii) an increase in the installed base of third party products of approximately $1.4 million, and (iii) an increase in other miscellaneous costs of $0.2 million. Overall, the gross margin percentage on Customer support revenues increased to approximately 89% from approximately 87%.

4) Professional Service and Other:

Professional service and other revenues consist of revenues from consulting contracts and contracts to provide implementation, training and integration services (professional services). Other revenues consist of hardware revenues. These revenues are grouped within the “Professional service and other” category because they are relatively immaterial to our service revenues. Professional services are typically performed after the purchase of new software licenses. Cost of professional service and other revenues consists primarily of the costs of providing integration, configuration and training with respect to our various software products. The most significant components of these costs are personnel-related expenses, travel costs and third party subcontracting.

(In thousands)	Three Months Ended March 31, 2018	Change increase (decrease)	2017	Nine Months Ended March 31, 2018	Change increase (decrease)	2017
Professional Service and Other Revenues:						
Americas	$36,868	$ 5,969	$30,899	$113,119	$ 35,923	$77,196
EMEA	35,358	6,478	28,880	99,397	26,076	73,321
Asia Pacific	8,159	2,580	5,579	24,038	7,854	16,184
Total Professional Service and Other Revenues	80,385	15,027	65,358	236,554	69,853	166,701
Cost of Professional Service and Other Revenues	64,246	8,717	55,529	188,690	51,523	137,167
GAAP-based Professional Service and Other Gross Profit	$16,139	$ 6,310	$9,829	$47,864	$ 18,330	$29,534
GAAP-based Professional Service and Other Gross Margin %	20.1 %		15.0 %	20.2 %		17.7 %
% Professional Service and Other Revenues by Geography:						
Americas	45.9 %		47.3 %	47.8 %		46.3 %
EMEA	44.0 %		44.2 %	42.0 %		44.0 %
Asia Pacific	10.1 %		8.5 %	10.2 %		9.7 %

Professional service and other revenues increased by $15.0 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $5.0 million. Geographically, the overall increase was attributable to an increase in EMEA of $6.5 million, an increase in Americas of $6.0 million and an increase in Asia Pacific of $2.6 million.

Professional service and other revenues increased by $69.9 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, inclusive of the positive impact of foreign exchange of approximately $8.9 million. Geographically, the overall increase was attributable to an increase in Americas of $35.9 million, an increase in EMEA of $26.1 million and an increase in Asia Pacific of $7.9 million.

Cost of Professional service and other revenues increased by $8.7 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year, primarily as a result of an increase in labour-related costs of approximately $8.1 million, which was partly due to recent acquisitions, and an increase in other miscellaneous costs of $0.6 million. Overall, the gross margin percentage on Professional service and other revenues increased to approximately 20% from approximately 15%. We are seeing improved margins in Professional service and other revenues as a result of our recent acquisitions, as they on-board to our operating model.

Cost of Professional service and other revenues increased by $51.5 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year, primarily as a result of an increase in labour-related costs of approximately $48.3 million, which was predominantly due to recent acquisitions, and an increase in other miscellaneous costs of $3.2 million. Overall, the gross margin percentage on Professional service and other revenues increased to approximately 20% from approximately 18%.

Amortization of Acquired Technology-based Intangible Assets

(In thousands)	Three Months Ended March 31, 2018	Change increase (decrease)	2017	Nine Months Ended March 31, 2018	Change increase (decrease)	2017
Amortization of acquired technology-based intangible assets	$47,303	$ 8,018	$39,285	$138,391	$ 51,123	$87,268

Amortization of acquired technology-based intangible assets increased during the three and nine months ended March 31, 2018 by $8.0 million and $51.1 million, respectively, as compared to the same periods in the prior fiscal

year. This was due to an increase in amortization of $9.9 million and $56.5 million, respectively, relating to newly acquired technology-based intangible assets from our acquisitions of Hightail, Guidance, Covisint, certain assets and liabilities of the enterprise content division of EMC Corporation (ECD Business), certain customer communication management software assets and liabilities from HP Inc. (CCM Business), and Recommind Inc. The increase in amortization was partially offset by a reduction of $1.9 million and $5.4 million, respectively, relating to intangible assets pertaining to certain previous acquisitions becoming fully amortized.

Operating Expenses

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Research and development	$83,522	$6,436	$77,086	$241,455	$41,076	$200,379
Sales and marketing	129,987	12,489	117,498	381,951	66,654	315,297
General and administrative	54,817	9,989	44,828	152,717	29,778	122,939
Depreciation	23,093	6,536	16,557	64,042	16,914	47,128
Amortization of acquired customer-based intangible assets	46,762	5,937	40,825	136,819	28,571	108,248
Special charges (recoveries)	2,644	(17,942)	20,586	21,390	(22,767)	44,157
Total operating expenses	$340,825	$23,445	$317,380	$998,374	$160,226	$838,148
% of Total Revenues:						
Research and development	12.2 %		13.0 %	11.7 %		12.3 %
Sales and marketing	19.0 %		19.8 %	18.5 %		19.4 %
General and administrative	8.0 %		7.6 %	7.4 %		7.6 %
Depreciation	3.4 %		2.8 %	3.1 %		2.9 %
Amortization of acquired customer-based intangible assets	6.8 %		6.9 %	6.6 %		6.7 %
Special charges (recoveries)	0.4 %		3.5 %	1.0 %		2.7 %

Research and development expenses consist primarily of payroll and payroll-related benefits expenses, contracted research and development expenses, and facility costs. Research and development assists with organic growth and improves product stability and functionality, and accordingly, we dedicate extensive efforts to update and upgrade our product offerings. The primary driver is typically budgeted software upgrades and software development.

(In thousands)	Quarter-over-Quarter Change between Fiscal 2018 and 2017	YTD-over-YTD Change between Fiscal 2018 and 2017
Payroll and payroll-related benefits	$ 8,413	$ 33,249
Contract labour and consulting	(2,070)	363
Share-based compensation	(641)	(1,166)
Travel and communication	(407)	(267)
Facilities	688	8,278
Other miscellaneous	453	619
Total year-over-year change in research and development expenses	$ 6,436	$ 41,076

Research and development expenses increased by $6.4 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and payroll-related benefits of $8.4 million, an increase in the use of facility and related resources of $0.7 million, which were partly the result of recent acquisitions. These were partially offset by a decrease in contract labour and consulting of $2.1 million and a decrease in share-based compensation expense of $0.6 million. Overall, our research and development expenses, as a percentage of total revenues, decreased to approximately 12% from approximately 13%.

Research and development expenses increased by $41.1 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and payroll-related benefits of $33.2 million, an increase in the use of facility and related resources of $8.3 million, which were predominantly the result of recent acquisitions, and an increase in contract labour and consulting of $0.4 million. These were partially offset by a decrease in share-based compensation expense of $1.2 million. Overall, our research and development expenses, as a percentage of total revenues, remained stable at approximately 12%.

Our research and development labour resources increased by 475 employees, from 2,790 employees at March 31, 2017 to 3,265 employees at March 31, 2018, primarily as a result of our recent acquisitions.

Sales and marketing expenses consist primarily of personnel expenses and costs associated with advertising, marketing and trade shows.

(In thousands)	Quarter-over-Quarter Change between Fiscal 2018 and 2017	YTD-over-YTD Change between Fiscal 2018 and 2017
Payroll and payroll-related benefits	$ 11,688	$ 41,122
Commissions	(140)	12,691
Contract labour and consulting	(94)	645
Share-based compensation	(590)	(556)
Travel and communication	(1,434)	1,513
Marketing expenses	(2,277)	104
Facilities	2,087	6,741
Other miscellaneous	3,249	4,394
Total year-over-year change in sales and marketing expenses	$ 12,489	$ 66,654

Sales and marketing expenses increased by $12.5 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and payroll-related benefits of $11.7 million and an increase in facility and related resources of $2.1 million, both of which were partly the result of recent acquisitions. Overall, our sales and marketing expenses, as a percentage of total revenues, decreased to approximately 19% from approximately 20%.

Sales and marketing expenses increased by $66.7 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and payroll-related benefits of $41.1 million and an increase in facility and related resources of $6.7 million, both of which were predominantly the result of recent acquisitions. Additionally, commissions expense increased by $12.7 million in conjunction with higher revenues. The remainder of the change was primarily attributable to normal growth in our business operations. Overall, our sales and marketing expenses, as a percentage of total revenues, remained stable at approximately 19%.

Our sales and marketing labour resources increased by 84 employees, from 1,885 employees at March 31, 2017 to 1,969 employees at March 31, 2018, primarily as a result of our recent acquisitions.

General and administrative expenses consist primarily of payroll and payroll related benefits expenses, related overhead, audit fees, other professional fees, consulting expenses and public company costs.

(In thousands)	Quarter-over-Quarter Change between Fiscal 2018 and 2017	YTD-over-YTD Change between Fiscal 2018 and 2017
Payroll and payroll-related benefits	$ 6,035	$ 18,095
Contract labour and consulting	(556)	(2,289)
Share-based compensation	(266)	(944)
Travel and communication	(101)	969
Facilities	85	1,934
Other miscellaneous	4,792	12,013
Total year-over-year change in general and administrative expenses	$ 9,989	$ 29,778

General and administrative expenses increased by $10.0 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and payroll-related benefits of $6.0 million, which was partly the result of recent acquisitions, and an increase in other miscellaneous expenses of $4.8 million, which includes professional fees such as legal, audit and tax related expenses. These increases were partially offset by a $0.6 million reduction in contract labour and consulting. The remainder of the change was attributable to normal growth in our business operations. Overall, general and administrative expenses, as a percentage of total revenue remained stable at approximately 8%.

General and administrative expenses increased by $29.8 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year. This was primarily due to an increase in payroll and

payroll-related benefits of $18.1 million and an increase in facilities expense of $1.9 million, which was predominantly the result of recent acquisitions, and an increase in other miscellaneous expenses of $12.0 million, which includes professional fees such as legal, audit and tax related expenses. These were partially offset by a $2.3 million reduction in contract labour and consulting and a

$0.9 million reduction in share-based compensation expense. The remainder of the change was attributable to normal growth in our business operations. Overall, general and administrative expenses, as a percentage of total revenue decreased slightly to 7% from approximately 8%.

Our general and administrative labour resources increased by 128 employees, from 1,384 employees at March 31, 2017 to 1,512 employees at March 31, 2018, primarily as a result of our recent acquisitions.

Depreciation expenses:

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Depreciation	$23,093	$ 6,536	$16,557	64,042	16,914	47,128

Depreciation expenses increased by $6.5 million and $16.9 million, respectively, during the three and nine months ended March 31, 2018 as compared to the same periods in the prior fiscal year, in accordance with increased capital asset expenditures. Depreciation expense remained relatively stable as a percentage of total revenue, at approximately 3%.

Amortization of acquired customer-based intangible assets:

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Amortization of acquired customer-based intangible assets	$46,762	$ 5,937	$40,825	$136,819	$ 28,571	$108,248

Acquired customer-based intangible assets amortization expense increased by $5.9 million and $28.6 million, respectively, during the three and nine months ended March 31, 2018 as compared to the same periods in the prior fiscal year. This was primarily due to an increase in amortization of $6.8 million and $34.5 million, respectively, relating to newly acquired customer-based intangible assets from our acquisitions of Hightail, Guidance, Covisint, ECD Business, CCM Business, and Recommind. This increase in amortization was partially offset by a reduction of $0.9 million and $5.9 million, respectively, relating to certain customer-based intangible assets pertaining to previous acquisitions becoming fully amortized.

Special charges (recoveries):

Special charges typically relate to amounts that we expect to pay in connection with restructuring plans relating to employee workforce reduction and abandonment of excess facilities, acquisition-related costs and other similar one-time charges and recoveries. Generally, we implement such plans in the context of integrating existing OpenText operations with that of acquired entities. Actions related to such restructuring plans are typically completed within a period of one year. In certain limited situations, if the planned activity does not need to be implemented, or an expense lower than anticipated is paid out, we record a recovery of the originally recorded expense to Special charges.

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Special charges (recoveries)	$2,644	$(17,942)	$20,586	$21,390	$(22,767)	$44,157

Special charges decreased by $17.9 million during the three months ended March 31, 2018 as compared to the same period in the prior fiscal year. The decrease was primarily due to (i) a $17.7 million reduction in restructuring activities, (ii) a reduction in acquisition related costs of $3.5 million, and (iii) a reduction in expense of $2.6 million relating to an Enterprise Resource Planning (ERP) implementation project that was implemented in early July 2017. These decreases were partially offset by (i) an increase of $2.7 million relating to a recovery of commitment fees in Fiscal 2017 that did not reoccur in Fiscal 2018, (ii) an increase of $1.7 million relating to system implementation

costs, (iii) an increase of $0.6 million relating to a lower net impact of reversals from certain pre-acquisition sales and use tax liabilities and interest being settled, or in certain instances, becoming statute barred, as compared to the prior fiscal year, and (iv) an increase of $0.5 million relating to post-acquisition integration costs necessary to streamline acquired companies into our operations. The remainder of the change is due to miscellaneous items.

Special charges decreased by $22.8 million during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year. The decrease was primarily due to (i) a reduction in acquisition related costs of $10.7 million, (ii) a

reduction in expense of $6.5 million relating to commitments fees incurred during Fiscal 2017 that did not reoccur in Fiscal 2018, (iii) a $5.8 million reduction in restructuring activities, (iv) a reduction in expense of $3.8 million relating to an ERP implementation project that was implemented in early July 2017, and (v) a reduction in expenses of $0.6 million relating to post-acquisition integration costs necessary to streamline acquired companies into our operations.These decreases were partially offset by (i) an increase of $1.7 million relating to system implementation costs, (ii) $0.7 million relating to a lower net impact of reversals from certain pre-acquisition sales and use tax liabilities and interest being settled, or in certain instances, becoming statute barred, as compared to the prior fiscal year. The remainder of the change is due to miscellaneous items.

For more details on Special charges (recoveries), see note 17 "Special Charges (Recoveries)" to our Condensed Consolidated Financial Statements.

Other Income (Expense), Net

Other income (expense), net relates to certain non-operational charges consisting primarily of transactional foreign exchange gains (losses). This income (expense) is dependent upon the change in foreign currency exchange rates vis-à-vis the functional currency of the legal entity. Other income (expense), net also includes our share of income or losses in non-marketable equity securities accounted for under the equity method.

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Foreign exchange gains (losses)	$9,980	$ 8,874	$1,106	$19,090	$ 20,856	$(1,766)
OpenText share in net income (loss) of equity investees	(304)	(467)	163	(502)	(6,663)	6,161
Income from long-term other receivable	1,327	1,327	—	1,327	1,327	—
Gain on shares held in Guidance [1]	—	—	—	841	841	—
Gain from contractual settlement [2]	—	—	—	5,000	5,000	—
Other miscellaneous income (expense)	137	(18)	155	1,155	985	170
Total other income (expense), net	$11,140	$ 9,716	$1,424	$26,911	$ 22,346	$4,565

[1] Represents the release to income from other comprehensive income relating to the mark to market on shares we held in Guidance prior to our acquisition in the first quarter of Fiscal 2018.

[2] Represents a gain recognized in connection with the settlement of a certain breach of contractual arrangement in the second quarter of Fiscal 2018.

Interest and Other Related Expense, Net

Interest and other related expense, net is primarily comprised of interest paid and accrued on our debt facilities, offset by interest income earned on our cash and cash equivalents.

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Interest and other related expense, net	$34,534	$ 2,800	$31,734	$101,914	$ 15,162	$86,752

Interest and other related expense, net increased by $2.8 million and $15.2 million, respectively, during the three and nine months ended March 31, 2018 as compared to the same periods in the prior fiscal year. This was primarily due to additional interest incurred relating to outstanding balances on the Revolver (as defined herein) of $1.4 million and $6.0 million, respectively. Also, for the nine months ended March 31, 2018, we incurred additional interest expense of $6.8 million relating to the reopening of Senior Notes 2026 (as defined herein), issued in December 2016.

For more details see note 10 "Long-Term Debt" to our Condensed Consolidated Financial Statements.

Provision for (Recovery of) Income Taxes

We operate in several tax jurisdictions and are exposed to various foreign tax rates. We also note that we are subject to tax rate discrepancies between our domestic tax rate and foreign tax rates that are significant and these discrepancies

are primarily related to earnings in the United States.

Please also see Part II, Item 1A "Risk Factors" elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended March 31,			Nine Months Ended March 31,		
(In thousands)	2018	Change increase (decrease)	2017	2018	Change increase (decrease)	2017
Provision for (recovery of) income taxes	$20,129	$ 6,890	$13,239	$100,644	$916,008	$(815,364)

In July 2016, we implemented a reorganization of our subsidiaries worldwide with the view to continuing to enhance operational and administrative efficiencies through further consolidated ownership, management, and development of our IP in Canada, continuing to reduce the number of entities in our group and working towards our objective of having a single operating legal entity in each jurisdiction. We believe our reorganization also reduces our exposure to global political and tax uncertainties, particularly in Europe. We believe that further consolidating our IP in Canada will continue to ensure appropriate legal protections for our consolidated IP, simplify legal, accounting and tax compliance, and improve our global cash management. A significant tax benefit of $876.1 million, associated primarily with the recognition of a net deferred tax asset arising from the entry of the IP into Canada, was recognized in the first quarter of Fiscal 2017. We believe it is more likely than not that the deferred tax asset will be realized and therefore no valuation allowance was required. We continue to evaluate our taxable position quarterly and consider factors by taxing jurisdiction, including but not limited to factors such as estimated taxable income, any historical experience of losses for tax purposes and the future growth of OpenText. This significant tax benefit is specifically tied to the reorganization and applied to the first quarter of Fiscal 2017 only and as a result, has not and will not continue in future periods.

The effective tax rate decreased to a provision of 25.5% for the three months ended March 31, 2018, from a provision of 37.9% for the three months ended March 31, 2017. Tax expense increased by $6.9 million, primarily due to (i) the impact of changes in US tax legislation in Fiscal 2018 resulting in a provisional expense of $4.7 million (see below), (ii) an increase of $8.2 million on account of the Company having higher income before taxes, including the impact of foreign tax rates, and (iii) an increase of $1.4 million relating to differences in tax filings from provisions, offset by (i) a decrease of $5.7 million resulting from the net impact of reversals and accruals of reserves, and (ii) a decrease of $1.2 million relating to a decrease in amortization of deferred charges. The remainder of the difference was due to normal course movements and non-material items.

The effective tax rate increased to a provision of 35.8% for the nine months ended March 31, 2018, compared to a recovery of 496.3% for the nine months ended March 31, 2017. The increase in tax expense of $916.0 million was primarily due to (i) a significant tax benefit of $876.1 million resulting from the Fiscal 2017 internal reorganization as described above which did not reoccur in Fiscal 2018, (ii) the impact of changes in US tax legislation in Fiscal 2018 resulting in a provisional charge of $20.0 million (see below), and (iii) an increase of $25.3 million on account of the Company having higher income before taxes, including the impact of foreign tax rates, offset by (i) a decrease of $0.5 million resulting from the net impact of reversals and accruals of reserves, (ii) a decrease of $1.2 million relating to differences in tax filings from provisions, and (iii) a decrease of $3.3 million relating to a decrease in amortization of deferred charges. The remainder of the difference was due to normal course movements and non-material items.

For information with regards to certain potential tax contingencies, see note 13 "Guarantees and Contingencies" to our Condensed Consolidated Financial Statements.

On December 22, 2017, the United States enacted tax reform legislation through the Tax Cuts and Jobs Act, which significantly changed the existing US tax laws, including a reduction in the federal corporate tax rate from 35% to 21%, and the transition of US international taxation from a worldwide tax system to a territorial tax system. As a result of the enactment of the legislation, the Company incurred a provisional one-time tax expense of $4.7 million for the three months ended March 31, 2018 and $20.0 million for the nine months ended March 31, 2018, respectively, primarily related to the transition tax on accumulated foreign earnings and the re-measurement of certain deferred tax assets and liabilities. The portion of this anticipated increase to tax expense attributable to the transition tax is payable over a period of up to eight years. The impact of the $20.0 million adjustment resulting from the US legislation on the effective tax rate is an increase of 6.0% for the three months ended March 31, 2018 and an increase of 7.1% for the nine months ended March 31, 2018.

The $20.0 million is a provisional amount in respect of rate change, Alternative Minimum Tax (AMT), and foreign earnings in accordance with Staff Accounting Bulletin 118 "Income Tax Accounting Implications of the Tax Cuts and Jobs Act" (SAB 118). The finalization of the provisional one-time amount is pending finalization of the re-assessment of the timing of reversals of certain deferred tax assets and liabilities and additional considerations related to undistributed foreign earnings and evaluating whether any portion of our existing AMT credit carryforwards are not expected to be refundable as a result of the repeal of corporate AMT. Additional information such as final Fiscal 2018 income and detailed earnings and profits calculations for foreign subsidiaries may result in changes to the provisional amount during the SAB 118 measurement period.

The Company continues to assess the impact of the new law on its consolidated financial statements and anticipates finalizing the determination on or before December 22, 2018 in accordance with SAB 118.

Use of Non-GAAP Financial Measures

In addition to reporting financial results in accordance with U.S. GAAP, the Company provides certain financial measures that are not in accordance with U.S. GAAP (Non-GAAP). These Non-GAAP financial measures have certain limitations in that they do not have a standardized meaning and thus the Company's definition may be different from similar Non-GAAP financial measures used by other companies and/or analysts and may differ from period to period. Thus it may be more difficult to compare the Company's financial performance to that of other companies. However, the Company's management compensates for these limitations by providing the relevant disclosure of the items excluded in the calculation of these Non-GAAP financial measures both in its reconciliation to the U.S. GAAP financial measures and its Condensed Consolidated Financial Statements, all of which should be considered when evaluating the Company's results.

The Company uses these Non-GAAP financial measures to supplement the information provided in its Condensed Consolidated Financial Statements, which are presented in accordance with U.S. GAAP. The presentation of Non-GAAP financial measures are not meant to be a substitute for financial measures presented in accordance with U.S. GAAP, but rather should be evaluated in conjunction with and as a supplement to such U.S. GAAP measures. OpenText strongly encourages investors to review its financial information in its entirety and not to rely on a single financial measure. The Company therefore believes that despite these limitations, it is appropriate to supplement the disclosure of the U.S. GAAP measures with certain Non-GAAP measures defined below.

Non-GAAP-based net income and Non-GAAP-based EPS, attributable to OpenText, are calculated as GAAP-based net income or earnings per share, attributable to OpenText, on a diluted basis, after giving effect to the amortization of acquired intangible assets, other income (expense), share-based compensation, and Special charges (recoveries), all net of tax and any tax benefits/expense items unrelated to current period income, as further described in the tables below. Non-GAAP-based gross profit is the arithmetical sum of GAAP-based gross profit and the amortization of acquired technology-based intangible assets and share-based compensation within cost of sales. Non-GAAP-based gross margin is calculated as Non-GAAP-based gross profit expressed as a percentage of total revenue.

Non-GAAP-based income from operations is calculated as GAAP-based income from operations, excluding the amortization of acquired intangible assets, Special charges (recoveries), and share-based compensation expense. Non-GAAP-based operating margin is calculated as Non-GAAP-based income from operations expressed as a percentage of total revenue.

Adjusted earnings (loss) before interest, taxes, depreciation and amortization (Adjusted EBITDA) is calculated as GAAP-based net income, attributable to OpenText excluding interest income (expense), provision for income taxes, depreciation and amortization of acquired intangible assets, other income (expense), share-based compensation and Special charges (recoveries).

The Company's management believes that the presentation of the above defined Non-GAAP financial measures provides useful information to investors because they portray the financial results of the Company before the impact of certain non-operational charges. The use of the term “non-operational charge” is defined for this purpose as an expense that does not impact the ongoing operating decisions taken by the Company's management and is based upon the way the Company's management evaluates the performance of the Company's business for use in the Company's internal reports. In the course of such evaluation and for the purpose of making operating decisions, the Company's management excludes certain items from its analysis, including amortization of acquired intangible assets, Special charges (recoveries), share-based compensation, other income (expense), and the taxation impact of these items. These items are excluded based upon the manner in which management evaluates the business of the Company and are not excluded in the sense that they may be used under U.S. GAAP.

The Company believes the provision of supplemental Non-GAAP measures allow investors to evaluate the operational and financial performance of the Company's core business using the same evaluation measures that management uses, and is therefore a useful indication of OpenText's performance or expected performance of future operations and facilitates period-to-period comparison of operating performance (although prior performance is not necessarily indicative of future performance). As a result, the Company considers it appropriate and reasonable to provide, in addition to U.S. GAAP measures, supplementary Non-GAAP financial measures that exclude certain items from the presentation of its financial results.

The following charts provide unaudited reconciliations of U.S. GAAP-based financial measures to Non-GAAP-based financial measures for the following periods presented:

Reconciliation of selected GAAP-based measures to Non-GAAP-based measures for the three months ended March 31, 2018
(in thousands except for per share data)

	Three Months Ended March 31, 2018					
	GAAP-based Measures	GAAP-based Measures % of Total Revenue	Adjustments	Note	Non-GAAP-based Measures	Non-GAAP-based Measures % of Total Revenue
Cost of revenues						
Cloud services and subscriptions	$94,264		$ (135)	(1)	$ 94,129	
Customer support	33,820		(277)	(1)	33,543	
Professional service and other	64,246		(122)	(1)	64,124	
Amortization of acquired technology-based intangible assets	47,303		(47,303)	(2)	—	
GAAP-based gross profit and gross margin (%) / Non-GAAP-based gross profit and gross margin (%)	443,148	64.6%	47,837	(3)	490,985	71.6%
Operating expenses						
Research and development	83,522		(993)	(1)	82,529	
Sales and marketing	129,987		(1,496)	(1)	128,491	
General and administrative	54,817		(2,057)	(1)	52,760	
Amortization of acquired customer-based intangible assets	46,762		(46,762)	(2)	—	
Special charges (recoveries)	2,644		(2,644)	(4)	—	
GAAP-based income from operations and operating margin (%) / Non-GAAP-based income from operations and operating margin (%)	102,323	14.9%	101,789	(5)	204,112	29.8%
Other income (expense), net	11,140		(11,140)	(6)	—	
Provision for (recovery of) income taxes	20,129		3,612	(7)	23,741	
GAAP-based net income / Non-GAAP-based net income, attributable to OpenText	58,794		87,037	(8)	145,831	
GAAP-based earnings per share / Non-GAAP-based earnings per share-diluted, attributable to OpenText	$0.22		$ 0.32	(8)	$ 0.54	

(1) Adjustment relates to the exclusion of share-based compensation expense from our Non-GAAP-based operating expenses as this expense is excluded from our internal analysis of operating results.

(2) Adjustment relates to the exclusion of amortization expense from our Non-GAAP-based operating expenses as the timing and frequency of amortization expense is dependent on our acquisitions and is hence excluded from our internal analysis of operating results.

(3) GAAP-based and Non-GAAP-based gross profit stated in dollars and gross margin stated as a percentage of total revenue.

(4) Adjustment relates to the exclusion of Special charges (recoveries) from our Non-GAAP-based operating expenses as Special charges (recoveries) are generally incurred in the periods relevant to an acquisition and include one-time, non-recurring charges or recoveries that are not indicative or related to continuing operations, and are therefore excluded from our internal analysis of operating results. See note 17 "Special Charges (Recoveries)" to

our Condensed Consolidated Financial Statements for more details.

(5) GAAP-based and Non-GAAP-based income from operations stated in dollars and operating margin stated as a percentage of total revenue.

(6) Adjustment relates to the exclusion of Other income (expense) from our Non-GAAP-based operating expenses as Other income (expense) relates primarily to the transactional impact of foreign exchange and is generally not indicative or related to continuing operations and is therefore excluded from our internal analysis of operating results. Other income (expense) also includes our share of income (losses) from our holdings in non-marketable securities investments as a limited partner. We do not actively trade equity securities in these privately held companies nor do we plan our ongoing operations based around any anticipated fundings or distributions from these investments. We exclude gains and losses on these investments as we do not believe they are reflective of our ongoing business and operating results.

(7) Adjustment relates to differences between the GAAP-based tax provision rate of approximately 26% and a Non-GAAP-based tax rate of approximately 14%; these rate differences are due to the income tax effects of expenses that are excluded for the purpose of calculating Non-GAAP-based adjusted net income. Such excluded expenses include amortization, share-based compensation, Special charges (recoveries) and other income (expense), net. Also excluded are tax benefits/expense items unrelated to current period income such as changes in reserves for tax uncertainties and valuation allowance reserves, and “book to return” adjustments for tax return filings and tax assessments. Included is the amount of net tax benefits arising from the internal reorganization (see note 14 "Income Taxes") assumed to be allocable to the current period based on the forecasted utilization period. In arriving at our Non-GAAP-based tax rate of approximately 14%, we analyzed the individual adjusted expenses and took into consideration the impact of statutory tax rates from local jurisdictions incurring the expense. We also took into consideration changes in US tax reform legislation that was enacted on December 22, 2017 through the Tax Cuts and Jobs Act.

(8) Reconciliation of GAAP-based net income to Non-GAAP-based net income:

	Three Months Ended March 31, 2018	
		Per share diluted
GAAP-based net income, attributable to OpenText	$58,794	$0.22
Add:		
Amortization	94,065	0.35
Share-based compensation	5,080	0.02
Special charges (recoveries)	2,644	0.01
Other (income) expense, net	(11,140)	(0.04)
GAAP-based provision for (recovery of) income taxes	20,129	0.07
Non-GAAP-based provision for income taxes	(23,741)	(0.09)
Non-GAAP-based net income, attributable to OpenText	$145,831	$0.54

Reconciliation of Adjusted EBITDA

	Three Months Ended March 31, 2018
GAAP-based net income, attributable to OpenText	$58,794
Add:	
Provision for (recovery of) income taxes	20,129
Interest and other related expense, net	34,534
Amortization of acquired technology-based intangible assets	47,303
Amortization of acquired customer-based intangible assets	46,762
Depreciation	23,093
Share-based compensation	5,080
Special charges (recoveries)	2,644
Other (income) expense, net	(11,140)
Adjusted EBITDA	$227,199

Reconciliation of selected GAAP-based measures to Non-GAAP-based measures for the three months ended March 31, 2017
(in thousands except for per share data)

	Three Months Ended March 31, 2017					
	GAAP-based Measures	GAAP-based Measures % of Total Revenue	Adjustments	Note	Non-GAAP-based Measures	Non-GAAP-based Measures % of Total Revenue
Cost of revenues						
Cloud services and subscriptions	$77,225		$ (268)	(1)	$ 76,957	
Customer support	34,442		(261)	(1)	34,181	
Professional service and other	55,529		(89)	(1)	55,440	
Amortization of acquired technology-based intangible assets	39,285		(39,285)	(2)	—	
GAAP-based gross profit and gross margin (%) / Non-GAAP-based gross profit and gross margin (%)	382,641	64.5%	39,903	(3)	422,544	71.2%
Operating expenses						
Research and development	77,086		(1,634)	(1)	75,452	
Sales and marketing	117,498		(2,081)	(1)	115,417	
General and administrative	44,828		(2,328)	(1)	42,500	
Amortization of acquired customer-based intangible assets	40,825		(40,825)	(2)	—	
Special charges (recoveries)	20,586		(20,586)	(4)	—	
GAAP-based income from operations and operating margin (%) / Non-GAAP-based income from operations and operating margin (%)	65,261	11.0%	107,357	(5)	172,618	29.1%
Other income (expense), net	1,424		(1,424)	(6)	—	
Provision for (recovery of) income taxes	13,239		7,798	(7)	21,037	
GAAP-based net income / Non-GAAP-based net income, attributable to OpenText	21,616		98,135	(8)	119,751	
GAAP-based earnings per share / Non-GAAP-based earnings per share-diluted, attributable to OpenText	$0.08		$ 0.37	(8)	$ 0.45	

(1) Adjustment relates to the exclusion of share-based compensation expense from our Non-GAAP-based operating expenses as this expense is excluded from our internal analysis of operating results.

(2) Adjustment relates to the exclusion of amortization expense from our Non-GAAP-based operating expenses as the timing and frequency of amortization expense is dependent on our acquisitions and is hence excluded from our internal analysis of operating results.

(3) GAAP-based and Non-GAAP-based gross profit stated in dollars and gross margin stated as a percentage of total revenue.

(4) Adjustment relates to the exclusion of Special charges (recoveries) from our Non-GAAP-based operating expenses as Special charges (recoveries) are generally incurred in the periods relevant to an acquisition and include one-time, non-recurring charges or recoveries that are not indicative or related to continuing operations, and are therefore excluded from our internal analysis of operating results. See note 17 "Special Charges (Recoveries)" to

our Condensed Consolidated Financial Statements for more details.

(5) GAAP-based and Non-GAAP-based income from operations stated in dollars and operating margin stated as a percentage of total revenue.

(6) Adjustment relates to the exclusion of Other income (expense) from our Non-GAAP-based operating expenses as Other income (expense) relates primarily to the transactional impact of foreign exchange and is generally not indicative or related to continuing operations and is therefore excluded from our internal analysis of operating results. Other income (expense) also includes our share of income (losses) from our holdings in non-marketable securities investments as a limited partner. We do not actively trade equity securities in these privately held companies nor do we plan our ongoing operations based around any anticipated fundings or distributions from these investments. We exclude gains and losses on these investments as we do not believe they are reflective of our ongoing business and operating results.

(7) Adjustment relates to differences between the GAAP-based tax provision rate of approximately 38% and a Non-GAAP-based tax rate of approximately 15%; these rate differences are due to the income tax effects of expenses that are excluded for the purpose of calculating Non-GAAP-based adjusted net income. Such excluded expenses include amortization, share-based compensation, Special charges (recoveries) and other income (expense), net. Also excluded are tax benefits/expense items unrelated to current period income such as changes in reserves for tax uncertainties and valuation allowance reserves, and “book to return” adjustments for tax return filings and tax assessments. Included is the amount of net tax benefits arising from the internal reorganization (see note 14 "Income Taxes") assumed to be allocable to the current period based on the forecasted utilization period. In arriving at our Non-GAAP-based tax rate of approximately 15%, we analyzed the individual adjusted expenses and took into consideration the impact of statutory tax rates from local jurisdictions incurring the expense.

(8) Reconciliation of GAAP-based net income to Non-GAAP-based net income:

	Three Months Ended March 31, 2017	
		Per share diluted
GAAP-based net income, attributable to OpenText	$21,616	$0.08
Add:		
Amortization	80,110	0.30
Share-based compensation	6,661	0.03
Special charges (recoveries)	20,586	0.08
Other (income) expense, net	(1,424)	(0.01)
GAAP-based provision for (recovery of) income taxes	13,239	0.05
Non-GAAP-based provision for income taxes	(21,037)	(0.08)
Non-GAAP-based net income, attributable to OpenText	$119,751	$0.45

Reconciliation of Adjusted EBITDA

	Three Months Ended March 31, 2017
GAAP-based net income, attributable to OpenText	$21,616
Add:	
Provision for (recovery of) income taxes	13,239
Interest and other related expense, net	31,734
Amortization of acquired technology-based intangible assets	39,285
Amortization of acquired customer-based intangible assets	40,825
Depreciation	16,557
Share-based compensation	6,661
Special charges (recoveries)	20,586
Other (income) expense, net	(1,424)
Adjusted EBITDA	$189,079

Reconciliation of selected GAAP-based measures to Non-GAAP-based measures for the nine months ended March 31, 2018
(in thousands except for per share data)

	Nine Months Ended March 31, 2018					
	GAAP-based Measures	GAAP-based Measures % of Total Revenue	Adjustments	Note	Non-GAAP-based Measures	Non-GAAP-based Measures % of Total Revenue
Cost of revenues						
Cloud services and subscriptions	$269,012		$ (1,119)	(1)	$ 267,893	
Customer support	99,805		(933)	(1)	98,872	
Professional service and other	188,690		(1,322)	(1)	187,368	
Amortization of acquired technology-based intangible assets	138,391		(138,391)	(2)	—	
GAAP-based gross profit and gross margin (%) / Non-GAAP-based gross profit and gross margin (%)	1,354,428	65.7%	141,765	(3)	1,496,193	72.6%
Operating expenses						
Research and development	241,455		(4,206)	(1)	237,249	
Sales and marketing	381,951		(6,679)	(1)	375,272	
General and administrative	152,717		(6,214)	(1)	146,503	
Amortization of acquired customer-based intangible assets	136,819		(136,819)	(2)	—	
Special charges (recoveries)	21,390		(21,390)	(4)	—	
GAAP-based income from operations and operating margin (%) / Non-GAAP-based income from operations and operating margin (%)	356,054	17.3%	317,073	(5)	673,127	32.7%
Other income (expense), net	26,911		(26,911)	(6)	—	
Provision for (recovery of) income taxes	100,644		(20,674)	(7)	79,970	
GAAP-based net income / Non-GAAP-based net income, attributable to OpenText	180,501		310,836	(8)	491,337	
GAAP-based earnings per share / Non-GAAP-based earnings per share-diluted, attributable to OpenText	$0.68		$ 1.16	(8)	$ 1.84	

(1) Adjustment relates to the exclusion of share-based compensation expense from our Non-GAAP-based operating expenses as this expense is excluded from our internal analysis of operating results.

(2) Adjustment relates to the exclusion of amortization expense from our Non-GAAP-based operating expenses as the timing and frequency of amortization expense is dependent on our acquisitions and is hence excluded from our internal analysis of operating results.

(3) GAAP-based and Non-GAAP-based gross profit stated in dollars and gross margin stated as a percentage of total revenue.

(4) Adjustment relates to the exclusion of Special charges (recoveries) from our Non-GAAP-based operating expenses as Special charges (recoveries) are generally incurred in the periods relevant to an acquisition and include one-time, non-recurring charges or recoveries that are not indicative or related to continuing operations, and are

therefore excluded from our internal analysis of operating results. See note 17 "Special Charges (Recoveries)" to our Condensed Consolidated Financial Statements for more details.

(5) GAAP-based and Non-GAAP-based income from operations stated in dollars and operating margin stated as a percentage of total revenue.

(6) Adjustment relates to the exclusion of Other income (expense) from our Non-GAAP-based operating expenses as Other income (expense) relates primarily to the transactional impact of foreign exchange and is generally not indicative or related to continuing operations and is therefore excluded from our internal analysis of operating results. Other income (expense) also includes our share of income (losses) from our holdings in non-marketable securities investments as a limited partner. We do not actively trade equity securities in these privately held companies nor do we plan our ongoing operations based around any anticipated fundings or distributions from these investments. We exclude gains and losses on these investments as we do not believe they are reflective of our ongoing business and operating results.

(7) Adjustment relates to differences between the GAAP-based tax provision rate of approximately 36% and a Non-GAAP-based tax rate of approximately 14%; these rate differences are due to the income tax effects of expenses that are excluded for the purpose of calculating Non-GAAP-based adjusted net income. Such excluded expenses include amortization, share-based compensation, Special charges (recoveries) and other income (expense), net. Also excluded are tax benefits/expense items unrelated to current period income such as changes in reserves for tax uncertainties and valuation allowance reserves, and “book to return” adjustments for tax return filings and tax assessments. Included is the amount of net tax benefits arising from the internal reorganization (see note 14 "Income Taxes") assumed to be allocable to the current period based on the forecasted utilization period. In arriving at our Non-GAAP-based tax rate of approximately 14%, we analyzed the individual adjusted expenses and took into consideration the impact of statutory tax rates from local jurisdictions incurring the expense. We also took into consideration changes in US tax reform legislation that was enacted on December 22, 2017 through the Tax Cuts and Jobs Act.

(8) Reconciliation of GAAP-based net income to Non-GAAP-based net income:

	Nine Months Ended March 31, 2018	
		Per share diluted
GAAP-based net income, attributable to OpenText	$180,501	$0.68
Add:		
Amortization	275,210	1.03
Share-based compensation	20,473	0.08
Special charges (recoveries)	21,390	0.08
Other (income) expense, net	(26,911)	(0.10)
GAAP-based provision for (recovery of) income taxes	100,644	0.37
Non-GAAP-based provision for income taxes	(79,970)	(0.30)
Non-GAAP-based net income, attributable to OpenText	$491,337	$1.84

Reconciliation of Adjusted EBITDA

	Nine Months Ended March 31, 2018
GAAP-based net income, attributable to OpenText	$180,501
Add:	
Provision for (recovery of) income taxes	100,644
Interest and other related expense, net	101,914
Amortization of acquired technology-based intangible assets	138,391
Amortization of acquired customer-based intangible assets	136,819
Depreciation	64,042
Share-based compensation	20,473
Special charges (recoveries)	21,390
Other (income) expense, net	(26,911)
Adjusted EBITDA	$737,263

Reconciliation of selected GAAP-based measures to Non-GAAP-based measures for the nine months ended March 31, 2017
(in thousands except for per share data)

	Nine Months Ended March 31, 2017					
	GAAP-based Measures	GAAP-based Measures % of Total Revenue	Adjustments	Note	Non-GAAP-based Measures	Non-GAAP-based Measures % of Total Revenue
Cost of revenues						
Cloud services and subscriptions	$220,667		$ (839)	(1)	$ 219,828	
Customer support	87,529		(766)	(1)	86,763	
Professional service and other	137,167		(1,002)	(1)	136,165	
Amortization of acquired technology-based intangible assets	87,268		(87,268)	(2)	—	
GAAP-based gross profit and gross margin (%) / Non-GAAP-based gross profit and gross margin (%)	1,084,628	66.6%	89,875	(3)	1,174,503	72.2%
Operating expenses						
Research and development	200,379		(5,372)	(1)	195,007	
Sales and marketing	315,297		(7,230)	(1)	308,067	
General and administrative	122,939		(7,164)	(1)	115,775	
Amortization of acquired customer-based intangible assets	108,248		(108,248)	(2)	—	
Special charges (recoveries)	44,157		(44,157)	(4)	—	
GAAP-based income from operations and operating margin (%) / Non-GAAP-based income from operations and operating margin (%)	246,480	15.1%	262,046	(5)	508,526	31.2%
Other income (expense), net	4,565		(4,565)	(6)	—	
Provision for (recovery of) income taxes	(815,364)		878,495	(7)	63,131	
GAAP-based net income / Non-GAAP-based net income, attributable to OpenText	979,522		(621,014)	(8)	358,508	
GAAP-based earnings per share / Non-GAAP-based earnings per share-diluted, attributable to OpenText	$3.88		$ (2.46)	(8)	$ 1.42	

(1) Adjustment relates to the exclusion of share-based compensation expense from our Non-GAAP-based operating expenses as this expense is excluded from our internal analysis of operating results.

(2) Adjustment relates to the exclusion of amortization expense from our Non-GAAP-based operating expenses as the timing and frequency of amortization expense is dependent on our acquisitions and is hence excluded from our internal analysis of operating results.

(3) GAAP-based and Non-GAAP-based gross profit stated in dollars and gross margin stated as a percentage of total revenue.

(4) Adjustment relates to the exclusion of Special charges (recoveries) from our Non-GAAP-based operating expenses as Special charges (recoveries) are generally incurred in the periods relevant to an acquisition and include one-time, non-recurring charges or recoveries that are not indicative or related to continuing operations, and are

therefore excluded from our internal analysis of operating results. See note 17 "Special Charges (Recoveries)" to our Condensed Consolidated Financial Statements for more details.

(5) GAAP-based and Non-GAAP-based income from operations stated in dollars and operating margin stated as a percentage of total revenue.

(6) Adjustment relates to the exclusion of Other income (expense) from our Non-GAAP-based operating expenses as Other income (expense) relates primarily to the transactional impact of foreign exchange and is generally not indicative or related to continuing operations and is therefore excluded from our internal analysis of operating results. Other income (expense) also includes our share of income (losses) from our holdings in non-marketable securities investments as a limited partner. We do not actively trade equity securities in these privately held companies nor do we plan our ongoing operations based around any anticipated fundings or distributions from these investments. We exclude gains and losses on these investments as we do not believe they are reflective of our ongoing business and operating results.

(7) Adjustment relates to differences between the GAAP-based tax recovery rate of approximately 496% and a Non-GAAP-based tax rate of approximately 15%; these rate differences are due to the income tax effects of expenses that are excluded for the purpose of calculating Non-GAAP-based adjusted net income. Such excluded expenses include amortization, share-based compensation, Special charges (recoveries) and other income (expense), net. Also excluded are tax benefits/expense items unrelated to current period income such as changes in reserves for tax uncertainties and valuation allowance reserves and “book to return” adjustments for tax return filings and tax assessments. Included is the amount of net tax benefits arising from the internal reorganization (see note 14 "Income Taxes") assumed to be allocable to the current period based on the forecasted utilization period. In arriving at our Non-GAAP-based tax rate of approximately 15%, we analyzed the individual adjusted expenses and took into consideration the impact of statutory tax rates from local jurisdictions incurring the expense.

(8) Reconciliation of GAAP-based net income to Non-GAAP-based net income:

	Nine Months Ended March 31, 2017	
		Per share diluted
GAAP-based net income, attributable to OpenText	$979,522	$3.88
Add:		
Amortization	195,516	0.77
Share-based compensation	22,373	0.09
Special charges (recoveries)	44,157	0.17
Other (income) expense, net	(4,565)	(0.02)
GAAP-based provision for (recovery of) income taxes	(815,364)	(3.23)
Non-GAAP-based provision for income taxes	(63,131)	(0.24)
Non-GAAP-based net income, attributable to OpenText	$358,508	$1.42

Reconciliation of Adjusted EBITDA

	Nine Months Ended March 31, 2017
GAAP-based net income, attributable to OpenText	$979,522
Add:	
Provision for (recovery of) income taxes	(815,364)
Interest and other related expense, net	86,752
Amortization of acquired technology-based intangible assets	87,268
Amortization of acquired customer-based intangible assets	108,248
Depreciation	47,128
Share-based compensation	22,373
Special charges (recoveries)	44,157
Other (income) expense, net	(4,565)
Adjusted EBITDA	$555,519

LIQUIDITY AND CAPITAL RESOURCES

The following tables set forth changes in cash flows from operating, investing and financing activities for the periods indicated:

(In thousands)	As of March 31, 2018	Change increase (decrease)	As of June 30, 2017
Cash and cash equivalents	$605,497	$162,140	$443,357

(In thousands)	Nine Months Ended March 31, 2018	Change	2017
Cash provided by operating activities	$504,426	$167,653	$336,773
Cash used in investing activities	$(415,237)	$1,743,282	$(2,158,519)
Cash provided by (used in) financing activities	$55,248	$(937,294)	$992,542

Cash and cash equivalents

Cash and cash equivalents primarily consist of balances with banks as well as deposits with original maturities of 90 days or less.

We continue to anticipate that our cash and cash equivalents, as well as available credit facilities, will be sufficient to fund our anticipated cash requirements for working capital, contractual commitments, capital expenditures, dividends and operating needs for the next twelve months. Any further material or acquisition-related activities may require additional sources of financing and would be subject to the financial covenants established under our credit facilities. For more details, see "Long-term Debt and Credit Facilities" below.

As of March 31, 2018, we have provided $28.3 million (June 30, 2017—$22.1 million) in respect of both additional foreign taxes or deferred income tax liabilities for temporary differences related to the undistributed earnings of certain non-United States subsidiaries, and planned periodic repatriations from certain United States and German subsidiaries, that will be subject to withholding taxes upon distribution.

Cash flows provided by operating activities

Cash flows from operating activities increased by $167.7 million due to an increase in net income before the impact of non-cash items of $251.1 million, partially offset by a decrease in changes from working capital of $83.4 million. The decrease in operating cash flow from changes in working capital was primarily due to the net impact of the following decreases: (i) $108.8 million relating to a lower accounts payable and accrued liabilities balance, (ii) $18.6 million relating to a higher accounts receivable balance, which is primarily due to increased billings associated with more revenue recognized during the nine months of Fiscal 2018 as compared to the same period in the prior fiscal year, (iii) $23.7 million relating to income taxes payable and deferred charges and credits, and (iv) $4.3 million relating to prepaid and other current assets. These decreases were partially offset by increases of (i) $67.8 million relating to deferred revenues and (ii) $4.2 million relating to other assets.

During the third quarter of Fiscal 2018 our days sales outstanding (DSO) was 67 days, compared to a DSO of 54 days during the third quarter of Fiscal 2017. We continue to work towards bringing all acquisitions on-board and aligning their historical payment terms with those of our OpenText policies and procedures.

The per day impact of our DSO in the third quarters of Fiscal 2018 and Fiscal 2017 on our cash flows was $7.6 million and $6.7 million, respectively.

Cash flows used in investing activities

Our cash flows used in investing activities is primarily on account of acquisitions and additions of property and equipment.

Cash flows used in investing activities decreased by $1.7 billion, primarily due to a decrease of $1.8 billion in consideration paid for acquisitions during the nine months ended March 31, 2018 as compared to the same period in the prior fiscal year.

Cash flows provided by (used in) financing activities

Our cash flows from financing activities generally consist of long-term debt financing and amounts received from stock options exercised by our employees. These inflows are typically offset by scheduled and non-scheduled repayments of our long-term debt financing and, when applicable, the payment of dividends and/or the repurchases of our Common Shares.

Cash flows provided by financing activities decreased by $937.3 million. This was primarily due to (i) net proceeds from our public offering of Common Shares during the second quarter of Fiscal 2017 which resulted in a cash inflow of approximately $584.8 million and did not reoccur during Fiscal 2018, (ii) the issuance of an additional $250 million in aggregate principal amount of Senior Notes 2026 at an issue price of 102.75% during the second quarter of Fiscal 2017, which resulted in cash inflow of approximately $256.9 million and did not reoccur during Fiscal 2018, (iii) repayments on the revolver of $100.0 million, (iv) a lower net impact of proceeds from drawings on the Revolver of $25.0 million, and (v) an increase in dividend payments made to our shareholders of $19.0 million. These decreases were partially offset by (i) an increase of $39.4 million relating to cash collected from the issuance of Common Shares for the exercise of options and the OpenText Employee Share Purchase Plan (ESPP), and (ii) $6.2 million in debt issuance costs paid during Fiscal 2017, relating to our Senior Notes 2026, which did not reoccur during Fiscal 2018. The remainder of the change was due to miscellaneous items.

Cash Dividends

During the three and nine months ended March 31, 2018, we declared and paid cash dividends of $0.1320 and $0.3960 per Common Share, respectively, that totaled $35.2 million and $105.0 million, respectively. Future declarations of dividends and the establishment of future record and payment dates are subject to the final determination and discretion of the Board. See Item 5 "Dividend Policy" in our Annual Report on Form 10-K for Fiscal 2017 for more information.

Long-term Debt and Credit Facilities

Senior Unsecured Fixed Rate Notes

Senior Notes 2026

On May 31, 2016 we issued $600 million in aggregate principal amount of 5.875% Senior Notes due 2026 (Senior Notes 2026) in an unregistered offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act, and to certain persons in offshore transactions pursuant to Regulation S under the Securities Act. Senior Notes 2026 bear interest at a rate of 5.875% per annum, payable semi-annually in arrears on June 1 and December 1, commencing on December 1, 2016. Senior Notes 2026 will mature on June 1, 2026, unless earlier redeemed, in accordance with their terms, or repurchased.

On December 20, 2016, we issued an additional $250 million in aggregate principal amount by reopening our Senior Notes 2026 at an issue price of 102.75%. The additional notes have identical terms, are fungible with and are a part of a single series with the previously issued $600 million aggregate principal amount of Senior Notes 2026. The outstanding aggregate principal amount of Senior Notes 2026, after taking into consideration the additional issuance, is $850 million.

We may redeem all or a portion of the Senior Notes 2026 at any time prior to June 1, 2021 at a redemption price equal to 100% of the principal amount of Senior Notes 2026 plus an applicable premium, plus accrued and unpaid interest, if any, to the redemption date. In addition, we may also redeem up to 40% of the aggregate principal amount of Senior Notes 2026, on one or more occasions, prior to June 1, 2019, using the net proceeds from certain qualified equity offerings at a redemption price of 105.875% of the principal amount, plus accrued and unpaid interest, if any, to the redemption date, subject to compliance with certain conditions. We may, on one or more occasions, redeem Senior Notes 2026, in whole or in part, at any time on and after June 1, 2021 at the applicable redemption prices set forth in the indenture governing the Senior Notes 2026, dated as of May 31, 2016, among the Company, the subsidiary guarantors party thereto, The Bank of New York Mellon, as U.S. trustee, and BNY Trust Company of Canada, as Canadian trustee (the 2026 Indenture), plus accrued and unpaid interest, if any, to the redemption date.

If we experience one of the kinds of changes of control triggering events specified in the 2026 Indenture, we will be required to make an offer to repurchase Senior Notes 2026 at a price equal to 101% of the principal amount of Senior Notes 2026, plus accrued and unpaid interest, if any, to the date of purchase.

The 2026 Indenture contains covenants that limit our and certain of our subsidiaries' ability to, among other things: (i) create certain liens and enter into sale and lease-back transactions; (ii) create, assume, incur or guarantee additional indebtedness of the Company or the guarantors without such subsidiary becoming a subsidiary guarantor of the notes; and (iii) consolidate, amalgamate or merge with, or convey, transfer, lease or otherwise dispose of its property and assets substantially as an entirety to, another person. These covenants are subject to a number of important limitations and exceptions as set forth in the 2026 Indenture. The 2026 Indenture also provides for events of default, which, if any of them occurs, may permit or, in

certain circumstances, require the principal, premium, if any, interest and any other monetary obligations on all the then-outstanding notes to be due and payable immediately.

Senior Notes 2026 are initially guaranteed on a senior unsecured basis by our existing and future wholly-owned subsidiaries that borrow or guarantee the obligations under our existing senior credit facilities. Senior Notes 2026 and the guarantees rank equally in right of payment with all of our and our guarantors' existing and future senior unsubordinated debt and will rank senior in right of payment to all of the our and our guarantors' future subordinated debt. Senior Notes 2026 and the guarantees will be effectively subordinated to all of our and our guarantors' existing and future secured debt, including the obligations under the senior credit facilities, to the extent of the value of the assets securing such secured debt.

The foregoing description of the 2026 Indenture does not purport to be complete and is qualified in its entirety by reference to the full text of the 2026 Indenture, which is filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on May 31, 2016.

Senior Notes 2023

On January 15, 2015, we issued $800 million in aggregate principal amount of our 5.625% Senior Notes due 2023 (Senior Notes 2023) in an unregistered offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act and to certain persons in offshore transactions pursuant to Regulation S under the Securities Act. Senior Notes 2023 bear interest at a rate of 5.625% per annum, payable semi-annually in arrears on January 15 and July 15, commencing on July 15, 2015. Senior Notes 2023 will mature on January 15, 2023, unless earlier redeemed in accordance with their terms, or repurchased.

We may, on one or more occasion, redeem Senior Notes 2023, in whole or in part, at any time on and after January 15, 2018 at the applicable redemption prices set forth in the indenture governing the Senior Notes 2023, dated as of January 15, 2015, among the Company, the subsidiary guarantors party thereto, The Bank of New York Mellon (as successor to Citibank N.A.), as U.S. trustee, and BNY Trust Company of Canada (as successor to Citi Trust Company Canada), as Canadian trustee (the 2023 Indenture), plus accrued and unpaid interest, if any, to the redemption date.

If we experience one of the kinds of changes of control triggering events specified in the 2023 Indenture, we will be required to make an offer to repurchase Senior Notes 2023 at a price equal to 101% of the principal amount of Senior Notes 2023, plus accrued and unpaid interest, if any, to the date of purchase.

The 2023 Indenture contains covenants that limit our and certain of our subsidiaries' ability to, among other things: (i) create certain liens and enter into sale and lease-back transactions; (ii) create, assume, incur or guarantee additional indebtedness of the Company or the subsidiary guarantors without such subsidiary becoming a subsidiary guarantor of Senior Notes 2023; and (iii) consolidate, amalgamate or merge with, or convey, transfer, lease or otherwise dispose of its property and assets substantially as an entirety to, another person. These covenants are subject to a number of important limitations and exceptions as set forth in the 2023 Indenture. The 2023 Indenture also provides for events of default, which, if any of them occurs, may permit or, in certain circumstances, require the principal, premium, if any, interest and any other monetary obligations on all the then-outstanding notes to be due and payable immediately.

Senior Notes 2023 are initially guaranteed on a senior unsecured basis by our existing and future wholly-owned subsidiaries that borrow or guarantee the obligations under our existing senior credit facilities. Senior Notes 2023 and the guarantees rank equally in right of payment with all of our and our subsidiary guarantors' existing and future senior unsubordinated debt and will rank senior in right of payment to all of our and our subsidiary guarantors' future subordinated debt. Senior Notes 2023 and the guarantees will be effectively subordinated to all of ours and our guarantors' existing and future secured debt, including the obligations under the Revolver and Term Loan B (as defined herein), to the extent of the value of the assets securing such secured debt.

The foregoing description of the 2023 Indenture does not purport to be complete and is qualified in its entirety by reference to the full text of the 2023 Indenture, which is filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on January 15, 2015.

Term Loan B

On January 16, 2014, we entered into a credit facility, which provides for a $800 million term loan facility with certain lenders named therein, Barclays Bank PLC (Barclays), as sole administrative agent and collateral agent, and with Barclays and RBC Capital Markets as lead arrangers and joint bookrunners (Term Loan B) and borrowed the full amount on January 16, 2014. Repayments made under Term Loan B are equal to 0.25% of the principal amount in

equal quarterly installments for the life of Term Loan B, with the remainder due at maturity.
Borrowings under Term Loan B are secured by a first charge over substantially all of our assets on a pari passu basis with the Revolver. Term Loan B has a seven year term.

Borrowings under Term Loan B bear interest at a rate per annum equal to an applicable margin plus, at the borrower's option, either (1) the eurodollar rate for the interest period relevant to such borrowing or (2) an ABR rate. The applicable margin for borrowings under Term Loan B is 2.00%, with respect to LIBOR advances and 1.00%, with respect to ABR advances. The interest on the current outstanding balance for Term Loan B is equal to 2.0% plus LIBOR. As of March 31, 2018, the outstanding balance on the Term Loan B bears an interest rate of approximately 3.65%.

Term Loan B has incremental facility capacity of (i) $250 million plus (ii) additional amounts, subject to meeting a "consolidated senior secured net leverage" ratio not exceeding 2.75:1.00, in each case subject to certain conditions. Consolidated senior secured net leverage ratio is defined for this purpose as the proportion of our total debt reduced by unrestricted cash, including guarantees and letters of credit, that is secured by our or any of our subsidiaries' assets, over our trailing twelve months net income before interest, taxes, depreciation, amortization, restructuring, share-based compensation and other miscellaneous charges.

Under Term Loan B, we must maintain a "consolidated net leverage" ratio of no more than 4:1 at the end of each financial quarter. Consolidated net leverage ratio is defined for this purpose as the proportion of our total debt reduced by unrestricted cash, including guarantees and letters of credit, over our trailing twelve months net income before interest, taxes, depreciation, amortization, restructuring, share-based compensation and other miscellaneous charges. As of March 31, 2018, our consolidated net leverage ratio was 2.0:1.

Revolver

We currently have a $450 million committed revolving credit facility (the Revolver) which matures on May 5, 2022. Borrowings under the Revolver are secured by a first charge over substantially all of our assets, and on a pari passu basis with Term Loan B. The Revolver has no fixed repayment date prior to the end of the term. Borrowings under the Revolver bear interest per annum at a floating rate of LIBOR plus a fixed margin dependent on our consolidated net leverage ratio ranging from 1.25% to 1.75%. As of March 31, 2018, the outstanding balance on the Revolver bears a weighted average interest rate of approximately 3.55%.

During the three and nine months ended March 31, 2018, we drew down nil and $200 million, respectively, from the Revolver to finance acquisitions (three and nine months ended March 31, 2017—$225 million, respectively).

During the three and nine months ended March 31, 2018, we repaid $100 million, respectively. (three and nine months ended March 31, 2017—nil, respectively).

As of March 31, 2018 we have an outstanding balance on the Revolver of $275 million (June 30, 2017—$175 million). We expect to repay the remaining balance within the next 12 months.

For the three and nine months ended March 31, 2018, we recorded interest expense of $2.7 million and $7.3 million, respectively, relating to amounts drawn on the Revolver (three and nine months ended March 31, 2017—$1.3 million, respectively).

From time to time we consider opportunities to re-balance and optimize our borrowings and capacity under our Term Loan B and Revolver, as market conditions permit.

For further details relating to our debt, please see note 10 "Long-Term Debt" to our Condensed Consolidated Financial Statements.

Shelf Registration Statement

On August 30, 2017, we filed a universal shelf registration statement on Form S-3 with the SEC, which became effective automatically (the Shelf Registration Statement). The Shelf Registration Statement allows for primary and secondary offerings from time to time of equity, debt and other securities, including Common Shares, Preference Shares, debt securities, depositary shares, warrants, purchase contracts, units and subscription receipts. A base shelf short-form prospectus qualifying the distribution of such securities was concurrently filed with Canadian securities regulators on August 30, 2017. The type of securities and the specific terms thereof will be determined at the time of any offering and will be described in the applicable prospectus supplement to be filed separately with the SEC and Canadian securities regulators.

Pensions

As of March 31, 2018, our total unfunded pension plan obligations were $65.0 million, of which $2.0 million is payable within the next twelve months. We expect to be able to make the long-term and short-term payments related to these obligations in the normal course of operations.

Our anticipated payments under our most significant plans for the fiscal years indicated below are as follows:

	Fiscal years ending June 30,		
	CDT	GXS GER	GXS PHP
2018 (three months ended June 30)	$159	$253	$25
2019	706	1,042	115
2020	760	1,050	154
2021	858	1,095	194
2022	945	1,106	297
2023 to 2027	5,912	5,895	2,056
Total	$9,340	$10,441	$2,841

For a detailed discussion on pensions, see note 11 "Pension Plans and Other Post Retirement Benefits" to our Condensed Consolidated Financial Statements.

Commitments and Contractual Obligations

As of March 31, 2018, we have entered into the following contractual obligations with minimum payments for the indicated fiscal periods as follows:

	Payments due between				
	Total	April 1, 2018—June 30, 2018	July 1, 2018—June 30, 2020	July 1, 2020—June 30, 2022	July 1, 2022 and beyond
Long-term debt obligations [1]	$3,424,525	$ 186,654	$ 389,329	$ 953,792	$ 1,894,750
Operating lease obligations [2]	397,539	20,530	140,044	105,496	131,469
Purchase obligations	17,867	2,622	14,439	806	—
	$3,839,931	$ 209,806	$ 543,812	$ 1,060,094	$ 2,026,219

[1] Includes interest up to maturity and principal payments. We currently have borrowings outstanding under the Revolver ($275 million as of March 31, 2018), which we expect to repay within the next 12 months. Please see note 10 "Long-Term Debt" to our Condensed Consolidated Financial Statements for more details.

[2] Net of $8.6 million of sublease income to be received from properties which we have subleased to third parties.

Guarantees and Indemnifications

We have entered into customer agreements which may include provisions to indemnify our customers against third party claims that our software products or services infringe certain third party intellectual property rights and for liabilities related to a breach of our confidentiality obligations. We have not made any material payments in relation to such indemnification provisions and have not accrued any liabilities related to these indemnification provisions in our Condensed Consolidated Financial Statements.

Occasionally, we enter into financial guarantees with third parties in the ordinary course of our business, including, among others, guarantees relating to taxes and letters of credit on behalf of parties with whom we conduct business. Such agreements have not had a material effect on our results of operations, financial position or cash flows.

Litigation

We are currently involved in various claims and legal proceedings.

Quarterly, we review the status of each significant legal matter and evaluate such matters to determine how they should be treated for accounting and disclosure purposes in accordance with the requirements of ASC Topic 450-20 "Loss Contingencies" (Topic 450-20). Specifically, this evaluation process includes the centralized tracking and itemization of the status of all our disputes and litigation items, discussing the nature of any litigation and claim, including any dispute or claim that is reasonably likely to result in litigation, with relevant internal and external counsel, and assessing the progress of each matter in light of its merits and our experience with similar proceedings under similar circumstances.

If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss in accordance with Topic 450-20. As of the date of this Quarterly Report on Form 10-Q, the aggregate of such estimated losses was not material to our consolidated financial position or result of

operations and we do not believe as of the date of this filing that it is reasonably possible that a loss exceeding the amounts already recognized will be incurred that would be material to our consolidated financial position or results of operations.

Contingencies

IRS Matter

As we have previously disclosed, the United States Internal Revenue Service (IRS) is examining certain of our tax returns for our fiscal year ended June 30, 2010 (Fiscal 2010) through our fiscal year ended June 30, 2012 (Fiscal 2012), and in connection with those examinations is reviewing our internal reorganization in Fiscal 2010 to consolidate certain intellectual property ownership in Luxembourg and Canada and our integration of certain acquisitions into the resulting structure. We also previously disclosed that the examinations may lead to proposed adjustments to our taxes that may be material, individually or in the aggregate, and that we have not recorded any material accruals for any such potential adjustments in our Condensed Consolidated Financial Statements.

As part of these examinations, which remain ongoing, on July 17, 2015 we received from the IRS an initial Notice of Proposed Adjustment (NOPA) in draft form proposing a one-time approximately $280 million increase to our U.S. federal taxes arising from the reorganization in Fiscal 2010 and proposing penalties equal to 20% of the additional taxes, plus interest at the applicable statutory rate (which will continue to accrue until the matter is resolved and may be substantial). A NOPA is an IRS position and does not impose an obligation to pay tax. The draft NOPA may be changed before the final NOPA is issued, including because the IRS reserved the right in the draft NOPA to increase the adjustment. Based on discussions with the IRS, we expect we will receive an additional NOPA proposing an approximately $80 million increase to our U.S. federal taxes for Fiscal 2012 arising from the integration of Global 360 Holding Corp. into the structure that resulted from the reorganization, accompanied by proposed penalties and interest (although there can be no assurance that this will be the amount reflected in the NOPA when received, including because the IRS may assign a higher value to our intellectual property). Depending upon the outcome of these matters, additional state income taxes plus penalties and interest may be due. We currently estimate that, as of March 31, 2018, adjustments under the draft NOPA in its present form and the anticipated additional NOPA could result in an aggregate liability of approximately $605 million, inclusive of U.S. federal and state taxes, penalties and interest. The increase from the initially disclosed estimated aggregate liability is solely due to an estimate of interest that has accrued.

We strongly disagree with the IRS' position and intend to vigorously contest the proposed adjustments to our taxable income. We are examining various alternatives available to taxpayers to contest the proposed adjustments. Any such alternatives could involve a lengthy process and result in the incurrence of significant expenses. As of the date of this Quarterly Report on Form 10-Q, we have not recorded any material accruals in respect of these examinations in our Condensed Consolidated Financial Statements. An adverse outcome of these tax examinations could have a material adverse effect on our financial position and results of operations.

CRA Matter

As part of its ongoing audit of our Canadian tax returns, the Canada Revenue Agency (CRA) has disputed our transfer pricing methodology used for certain intercompany transactions with our international subsidiaries. The CRA has issued a notice of reassessment for Fiscal 2012 that would, as drafted, increase our taxable income for that year by approximately $90 million (offset by the tax attributes referred to below) and apply a penalty of approximately 10%. We strongly disagree with the CRA position and believe the reassessment of Fiscal 2012 (including penalties) is without merit. We will continue to vigorously contest both the proposed adjustments to our taxable income and the penalty assessment. We have filed a notice of objection and will also seek competent authority consideration under applicable international treaties in respect of this reassessment. As of the date of this Quarterly Report on Form 10-Q, we have not recorded any accruals in respect of this reassessment in our Condensed Consolidated Financial Statements.

Even if we are unsuccessful in challenging the CRA's reassessment to increase our taxable income for Fiscal 2012, we have elective deductions available in Fiscal 2012 that would offset such increased amount so that no additional cash tax would be payable for Fiscal 2012, exclusive of any proposed penalties. Audits by the CRA of our tax returns for fiscal years prior to Fiscal 2012 have been completed with no reassessment of our income tax liability in respect of our international transactions, including the transfer pricing methodology applied to them. The CRA is currently

auditing Fiscal 2013, Fiscal 2014 and Fiscal 2015, and has proposed to reassess Fiscal 2013 in a manner consistent with the reassessment of Fiscal 2012. We are in ongoing discussions with the CRA and continue to vigorously contest the CRA's audit position.

GXS Brazil Matter

As part of our acquisition of GXS, we inherited a tax dispute in Brazil between the Company’s subsidiary, GXS Tecnologia da Informação (Brasil) Ltda. (GXS Brazil), and the municipality of São Paulo, in connection with GXS Brazil’s

judicial appeal of a tax claim. During the first quarter of Fiscal 2018 the courts ruled in favour of the municipality of São Paulo. The Company decided not to pursue further appeal. On October 1, 2017, the Company reached a settlement with the municipality and paid $1.4 million.

Historically, prior to our acquisition of GXS, GXS would charge certain costs to its subsidiaries, including GXS Brazil, primarily based on historical transfer pricing studies that were intended to reflect the costs incurred by subsidiaries in relation to services provided by the parent company to the subject subsidiary. GXS recorded taxes on amounts billed, that were considered to be due based on the intercompany charges. GXS subsequently re-evaluated its intercompany charges to GXS Brazil and related taxes and, upon taking into consideration the current environment and judicial proceedings in Brazil, concluded that it was probable that certain indirect taxes would be assessable and payable based upon the accrual of such intercompany charges and has approximately $1.8 million accrued for the probable amount of a settlement related to the indirect taxes, interest and penalties.

GXS India Matter

Our Indian subsidiary, GXS India Technology Centre Private Limited (GXS India), is subject to potential assessments by Indian tax authorities in the city of Bangalore. GXS India has received assessment orders from the Indian tax authorities alleging that the transfer price applied to intercompany transactions was not appropriate. Based on advice from our tax advisors, we believe that the facts that the Indian tax authorities are using to support their assessment are incorrect. We have filed appeals and anticipate an eventual settlement with the Indian tax authorities. We have accrued $1.4 million to cover our anticipated financial exposure in this matter.

Please also see Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for Fiscal 2017.

Off-Balance Sheet Arrangements

We do not enter into off-balance sheet financing as a matter of practice, except for guarantees relating to taxes and letters of credit on behalf of parties with whom we conduct business, and the use of operating leases for office space, computer equipment, and vehicles. None of the operating leases described in the previous sentence has, and we currently do not believe that they potentially may have, a material effect on our financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources. In accordance with U.S. GAAP, neither the lease liability nor the underlying asset is carried on the balance sheet, as the terms of the leases do not meet the criteria for capitalization.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are primarily exposed to market risks associated with fluctuations in interest rates on our term loans, revolving loans and foreign currency exchange rates.

Interest rate risk

Our exposure to interest rate fluctuations relate primarily to our Term Loan B and the Revolver.

As of March 31, 2018, we had an outstanding balance of $766.3 million on Term Loan B. Term Loan B bears a floating interest rate of 2.0% plus LIBOR. As of March 31, 2018, an adverse change of one percent on the interest rate would have the effect of increasing our annual interest payment on Term Loan B by approximately $7.7 million, assuming that the loan balance as of March 31, 2018 is outstanding for the entire period (June 30, 2017—$7.7 million).

As of March 31, 2018, we had an outstanding balance of $275 million on the Revolver. Borrowings under the Revolver bear interest per annum at a floating rate of LIBOR plus a fixed rate that is dependent on our consolidated net leverage ratio ranging from 1.25% to 1.75%. As of March 31, 2018, an adverse change of one percent on the interest rate would have the effect of increasing our annual interest payment on the Revolver by approximately $2.8 million, assuming that the loan balance is outstanding for the entire year (June 30, 2017—$1.8 million).

Foreign currency risk

Foreign currency transaction risk

We transact business in various foreign currencies. Our foreign currency exposures typically arise from intercompany fees, intercompany loans and other intercompany transactions that are expected to be cash settled in the near term. We expect that we will continue to realize gains or losses with respect to our foreign currency exposures. Our ultimate realized gain or loss with respect to foreign currency exposures will generally depend on the size and type of cross-currency transactions that we enter into, the currency exchange rates associated with these exposures and changes in those rates. Additionally, we have hedged certain of our Canadian dollar foreign currency exposures relating to our payroll expenses in Canada.

Based on the foreign exchange forward contracts outstanding as of March 31, 2018, a one cent change in the Canadian dollar to U.S. dollar exchange rate would have caused a change of approximately $0.5 million in the mark to market on our existing foreign exchange forward contracts (June 30, 2017—$0.4 million).

Foreign currency translation risk

Our reporting currency is the U.S. dollar. Fluctuations in foreign currencies impact the amount of total assets and liabilities that we report for our foreign subsidiaries upon the translation of these amounts into U.S. dollars. In particular, the amount of cash and cash equivalents that we report in U.S. dollars for a significant portion of the cash held by these subsidiaries is subject to translation variance caused by changes in foreign currency exchange rates as of the end of each respective reporting period (the offset to which is recorded to accumulated other comprehensive income on our Condensed Consolidated Balance Sheets).

The following table shows our cash and cash equivalents denominated in certain major foreign currencies as of March 31, 2018 (equivalent in U.S. dollar):

(In thousands)	U.S. Dollar Equivalent at March 31, 2018	U.S. Dollar Equivalent at June 30, 2017
Euro	$ 132,898	$ 121,621
British Pound	41,055	30,425
Canadian Dollar	15,671	29,131
Swiss Franc	23,540	41,925
Other foreign currencies	110,394	87,144
Total cash and cash equivalents denominated in foreign currencies	323,558	310,246
U.S. dollar	281,939	133,111
Total cash and cash equivalents	$ 605,497	$ 443,357

If overall foreign currency exchange rates in comparison to the U.S. dollar uniformly weakened by 10%, the amount of cash and cash equivalents we would report in equivalent U.S. dollars would decrease by approximately $32.4 million (June 30,

2017—$31.0 million), assuming we have not entered into any derivatives discussed above under "Foreign Currency Transaction Risk".

Item 4. Controls and Procedures

(A) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our management, with the participation of the Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of March 31, 2018, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act were recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that information required to be disclosed by us in the reports we file under the Exchange Act (according to Rule 13(a)-15(e)) is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

(B) Changes in Internal Control over Financial Reporting (ICFR)

Based on the evaluation completed by our management, in which our Chief Executive Officer and Chief Financial Officer participated, our management has concluded that there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the fiscal quarter ended March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - Other Information
Item 1A. Risk Factors
The following risk factors update, and are in addition to, the risk factors discussed in Part I, Item 1A, "Risk Factors" in our Annual Report on Form 10-K for our fiscal year ended June 30, 2017, and should be read in conjunction therewith. These are not the only risks and uncertainties facing us. Additional risks not currently known to us or that we currently believe are immaterial may also impair our operating results, financial condition and liquidity. Our business is also subject to general risks and uncertainties that affect many other companies.

Our provision for income taxes and effective income tax rate may vary significantly and may adversely affect our results of operations and cash resources
Significant judgment is required in determining our provision for income taxes. Various internal and external factors may have favorable or unfavorable effects on our future provision for income taxes, income taxes receivable, and our effective income tax rate. These factors include, but are not limited to, changes in tax laws, regulations and/or rates, including the Tax Cuts and Jobs Act which was enacted in the United States on December 22, 2017, results of audits by tax authorities, changing interpretations of existing tax laws or regulations, changes in estimates of prior years' items, the impact of transactions we complete, future levels of research and development spending, changes in the valuation of our deferred tax assets and liabilities, transfer pricing adjustments, changes in the overall mix of income among the different jurisdictions in which we operate, and changes in overall levels of income before taxes. Changes in the tax laws of various jurisdictions in which we do business could result from the base erosion and profit shifting (BEPS) project being undertaken by the Organization for Economic Co-operation and Development (OECD). The OECD, a coalition of member countries, has been developing recommendations for international tax rules to address different types of BEPS, including situations in which profits are shifted (or payments are made) from higher tax jurisdictions to lower tax jurisdictions. Adoption of these recommendations (or other changes in law or policy) by the countries in which we do business could adversely affect our provision for income taxes and our effective tax rate. Furthermore, new accounting pronouncements or new interpretations of existing accounting pronouncements (such as those that may be described in note 2 “Recent Accounting Pronouncements” in our notes to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q), and/or any internal restructuring initiatives we may implement from time to time to streamline our operations, can have a material impact on our effective income tax rate. In July 2016, we implemented a reorganization of our subsidiaries worldwide with the view to continuing to enhance operational and administrative efficiencies through further consolidated ownership, management, and development of our intellectual property (IP) in Canada, continuing to reduce the number of entities in our group and working towards our objective of having a single operational legal entity in each jurisdiction.
Tax examinations are often complex as tax authorities may disagree with the treatment of items reported by us and our transfer pricing methodology based upon our limited risk distributor model, the result of which could have a material adverse effect on our financial condition and results of operations. Although we believe our estimates are reasonable, the ultimate outcome with respect to the taxes we owe may differ from the amounts recorded in our financial statements, and this difference may materially affect our financial position and financial results in the period or periods for which such determination is made.
For more details of tax audits to which we are subject and the impact of the recently enacted Tax Cuts and Jobs Act in the United States, see notes 13 "Guarantees and Contingencies" and 14 "Income Taxes", respectively, to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Certain of our products may be perceived as, or determined by the courts to be, a violation of privacy rights and related laws. Any such perception or determination could adversely affect our revenues and results of operations.
Because of the nature of certain of our products, including those relating to digital investigations, potential customers and purchasers of our products or the public in general may perceive that use of these products may result in violations of their individual privacy rights. In addition, certain courts or regulatory authorities could determine that the use of our software solutions or other products is a violation of privacy laws, particularly in jurisdictions outside of the United States. Any such determination or perception by potential customers, the general public, government entities or the judicial system could harm our reputation and adversely affect our business, financial condition and

results of operations.

Item 6. Exhibits and Financial Statements Schedules

The following documents are filed as a part of this report:

Exhibit Number	Description of Exhibit
31.1	Certification of the Chief Executive Officer, pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL instance document.
101.SCH	XBRL taxonomy extension schema.
101.CAL	XBRL taxonomy extension calculation linkbase.
101.DEF	XBRL taxonomy extension definition linkbase.
101.LAB	XBRL taxonomy extension label linkbase.
101.PRE	XBRL taxonomy extension presentation.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.
OPEN TEXT CORPORATION
Date: May 9, 2018
By: /s/ MARK J. BARRENECHEA
Mark J. Barrenechea
Vice Chairman, Chief Executive Officer and Chief Technology Officer
(Principal Executive Officer)
/s/ MADHU RANGANATHAN
Madhu Ranganathan
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)
/s/ ADITYA MAHESHWARI
Aditya Maheshwari
Senior Vice President and Chief Accounting Officer
(Principal Accounting Officer)

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