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OTEX.TO - Q2 2020 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported YTD total revenues of $1.5b, GAAP net income of $181.9m and GAAP diluted EPS of $0.67. Also reported 2Q20 total revenue of $771.6m, GAAP net income of $107.5m and GAAP diluted EPS of $0.40.

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PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation Second Quarter Fiscal 2020 Conference Call. (Operator Instructions) And the conference is being recorded. (Operator Instructions)

I would now like to turn the conference over to Harry Blount, Senior Vice President, Investor Relations. Please go ahead.

Harry Blount - *Open Text Corporation - Senior VP & Global Head of IR*

Thank you, Ariel, and good afternoon, everyone. On the call today is OpenText's Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea; and our Executive Vice President and Chief Financial Officer, Madhu Ranganathan. We have some prepared remarks, which will be followed by a question-and-answer session. This call will last approximately 60 minutes with a replay available shortly thereafter.

I would like to take a moment and direct investors to the Investor Relations section of our website, investors.opentext.com, where we have posted 2 presentations that will supplement our prepared remarks today. First, our strategic overview, titled OpenText Investor Presentation, January 2020; the second, titled Q2 FY 2020 Financial and Business Results, includes information and financials specific to our quarterly results, notably our updated quarterly factors on Page 8.

In February and March, OpenText management is pleased to meet with investors throughout Canada and the United States. We look forward to attending the following conferences. The 8th capital Digital Disruption Forum on February 27, in Toronto; the Morgan Stanley Technology, Media & Telecom Conference on March 3, in San Francisco; and CIBC's tech tour on March 5, in Ottawa. Please feel free to reach out to me or the IR team for additional information.

And now I will proceed with the reading of our safe harbor statement. Please note that during the course of this conference call, we may make statements relating to the future performance of OpenText that contain forward-looking information. While these forward-looking statements represent our current judgment, actual results could differ materially from a conclusion, forecast or projection in the forward-looking statements made today. Certain material factors and assumptions were applied in drawing any such statement. Additional information about the material factors that could cause actual results to differ materially from a conclusion, forecast or projection in the forward-looking information as well as the risk factors that may project future performance results of OpenText are contained in OpenText's recent forms 10-K and 10-Q as well as in our press release that was distributed earlier this afternoon, and which may be found on our website. We undertake no obligation to update these forward-looking statements unless required to do so by law. In addition, our conference call may include discussions of certain non-GAAP financial measures. Reconciliations of any non-GAAP financial measures to their most directly comparable GAAP measures may be found within our public filings and other materials, which are available on our website. And with that, I will hand the call over to Mark.

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

Thank you, Harry. Good afternoon to everyone, and thank you for joining today's call. There are a variety of key topics I'd like to discuss today, our strategy, including the momentum of our cloud business and how the intelligent edge is going to play a larger role for OpenText. Second, Carbonite and our road map ahead. I'd like to discuss today our strong Q2 results, our go-to-market opportunity and partner strategy, the general M&A environment as we see it. And we introduced a guiding principle of durable in September of 2019. I plan to spend some time on that today in the OpenText's operating model and lastly, our financial outlook, both short and longer term.

Let me jump right in and speak to the strategy, the cloud and what I call the intelligent edge. We have successfully transformed into a modern cloud company, servicing the information needs of the world's largest enterprises and governments. And with Carbonite, we will bring the cloud and information management to customers of all sizes. From zero cloud revenue in 2012 to today, our cloud business has grown at 30% CAGR. And the OpenText cloud is on track to be the largest business segment in fiscal '21, approaching 3x our license business and larger than our maintenance business.

We have built a cloud business and delivered incredible growth while expanding license, expanding maintenance, expanding adjusted EBITDA and expanding cash flows. Our guide was to find new revenue dollars, not substitute an existing dollar for another one. This highlights our culture, the OpenText way and the OpenText Business System. We now have 3 primary cloud businesses of scale and significant total growth opportunities within each: Business Network, Content Services and Cyber Resilience.

The Business Network. We have one of the world's largest and most-advanced business networks. The business is benefiting from the structural changes in global trade, increased and changing tariffs, privacy, compliance and ethical trade. Secular trends are not likely to change anytime soon.

Content Services. We're in a data economy. You can't create an information advantage unless you have all the right data in the right place at the right time, in the same business context and always keep it up to date. Our content services business is benefiting from the move to digitize, standardize and centralize information from all sources, human and machine, structured and unstructured, to create a sustainable information advantage. We are the market and innovation leader in content services, both in the cloud and off cloud.

Cyber Resilience. We're also in a distributed nomadic data economy with data generated from billions of humans and endpoints, inside and outside their organizations, including suppliers, partners, customers and contractors. This environment creates significant challenges for corporate security officers to protect their environments.

Carbonite security. Now the Carbonite security cloud enables us to offer holistic security solutions to enterprise customers and all of the endpoints that touch their network, including small, medium businesses and professional consumers. We continue to drive rapid innovation across all of our cloud platforms. The upcoming release of Cloud Edition is an important waypoint on that journey. With 20.2, we have more of a SaaS, we have more SaaS services, and customers will never have to upgrade again. Our cloud business has never been stronger, and partners and customers, alike, are recognizing our leadership position. We connected with thousands of customers and prospects in our recent 24-city cloud tour. The shift in the cloud has profound long-term business impacts that enables us to simplify our go-to-market, improve sales productivity, drive speed to market and increase responsiveness to real-time changing customer needs. The net effect is higher customer renewal rates and satisfaction and increasing annual renewal rates or ARR, annual recurring revenue, ARR, and increasing the predictability of the business.

To reinforce this shift, check out our new homepage on www.opentext.com. You'll see 4 simple tiles now on our homepage. Log on to the OpenText cloud. I encourage you to click on it and see the 15 SaaS services we have live off opentext.com. Second tile, get support; third tile, the developer; and fourth, contact us.

But it's not just about the cloud. It is also about the edge, the intelligent edge. Some estimates speak to 1 trillion endpoints over the next 10 years by 2030, including all vehicles, machinery, engines, brake systems, medical devices, wearables, smart cellphones, laptops, tablets, robots and more.

The edges define the shape of the cloud. It defines where human innovate, work and play. It defines the expanding role machines will have in our society. With Carbonite, OpenText can uniquely offer cloud and edge solutions for intelligent, connected and secure Information management.

Let me give you a big number, 100 million. OpenText software is now running on 100 million endpoints by our estimates. This is opportunity in its purest form. And I'd like to say -- as I like to say, it's your edge, own it. We'll also see the benefits of this scale, and we have a clear path to drive our cloud business. We expect cloud margins to expand from the high 50s into the mid-60s, supporting our fiscal year '22 aspirations.

Finally, I think it's important to recognize that we have given our customers choice on how they want to do business with us in the cloud and off cloud. We have successfully grown our cloud business without sacrificing our license revenues or margins.

Let me turn to Carbonite. I'm pleased to announce that we completed the acquisition of Carbonite on December 24. I welcome our new employees, customers and partners to OpenText. Carbonite is a leading provider of cloud-based subscription backup, disaster recovery, endpoint security and threat intelligence. Combining Carbonite's data protection, backup and document retention, endpoint protection and threat intelligence solutions and our gold standard EnCase products will provide a comprehensive cyber resilience solution for customers that we believe is unmatched in the industry. That's why we use the term, cyber resilience.

The acquisition is our most significant since the purchase of Dell EMC of its Enterprise Content division, including Documentum and significantly enhances OpenText business mix and predictability. It's strategic on multiple vectors, and I'd like to walk through them today. First, Carbonite brings us leadership in the third pillar, the large and growing cyber resilience market, complementing our leadership positions in Content Services and Business Network. Second, it is expected to increase the annualized run rate of our cloud subscription businesses significantly and improve the future of productivity -- of predictability, rather, of our revenue stream. Third, Carbonite brings 16,000 new channel partners to OpenText and a new route to market that complements our strong enterprise sales capabilities. With Carbonite, we can now deliver world-class information management solutions to customers of all shapes and sizes. Fourth, we evolved from EIM to IM, from Enterprise Information Management to Information Management, expanding our vision of products to, again, all size customers from the largest enterprises, governments, midsized companies, small companies and professional consumers. And to round out our strategic rationale, the cloud opportunity is, of course, massive, and I've called it a once in 20-year opportunity, but equally important is the edge of the cloud. We work and innovate on endpoints on the edge of the cloud. The edge is mobile, expanding, smart and very personal. The OpenText opportunity just got larger by embracing the edge.

Let me also spend a few moments on the top 4 long-term growth opportunities for Carbonite. First, it is pretty straightforward. Expand the MSP and RMM channels and increase our reach. Second, unlock the OEM opportunity with BrightCloud. If you're not familiar with this service, please check out www.brightcloud.com or simply go to opentext.com and put down the log on the cloud button to look at BrightCloud. It is a great solution that authenticates every URL that it processes. Third, expand the Carbonite opportunity within the OpenText enterprise via what I call file integrity. Carbonite can provide endpoint data protection as well as ensure the authenticity and integrity of every file, which flows through Content Services in our Business Network. And fourth, bring Carbonite into Europe via OpenText scale. We'll be focusing on these top 4 value plays, among others, to pursue long-term growth opportunities.

Let me turn to our Q2 results. This is our 20th consecutive quarter of year-over-year total revenue growth. It is also our 20th consecutive quarter of year-over-year cloud revenue growth. Our talent and leadership are world-class. They delivered exceptional Q2 results in a volatile selling environment.

Let me walk through our results, and all my remarks are in constant currency and with year-over-year comparison. We had record total revenue of $782 million, up 6.3%; record ARR of $571 million, up 7.8%, the 73% of total revenue; cloud, up 14%; license, up 6%; CS, up 3%.; NPS, down slightly at 3%. We had positive organic growth within the quarter; adjusted EBITDA dollars of $323 million, up 5%; and an adjusted EBITDA margin of 41.4%. License margin of 98%. Cloud margin of 58%. CS margin of 91%. NPS margin of 24%. Adjusted EPS of $0.86, up 7.5%. Operating cash flows of $207 million, up 9.6%. Ending cash flow of $675 million. The net debt-to-adjusted EBITDA ratio of 2.3x. Off-cloud renewal rates were strong in the low 90s. Cloud renewal rates were in the mid- to high 90s. We had 45 new-managed service customers, including HSBC, Archer Daniels Midland and Wells Fargo.

Let me touch on some customer wins within the quarter. The first, the Netherlands Ministry of Economic Affairs and Climate Policy is the ministry that oversees national policies, including commercial, international and industrial trade, investment policy as well as all energy, renewable strategy, climate change and environmental policies. The ministry selected OpenText Information management solutions to digitize and automate government processes across multiple departments through a single platform in the cloud, enabling them to accelerate renewable energy and policies to support a stronger climate.

I'd also like to highlight a second win, the German Ministry of Justice Rhineland-Palatinate together with 3 other state judicial administration selecting OpenText intelligent capture to digitize up to 100 million pages of incoming documents in 1,000 workplaces as part of the introduction of electronic court records to accelerate the delivery of fair and just decisions. These are just a couple of highlights. Full customer wins can be seen in our investor deck.

I've talked a little bit about go-to-market, our go-to-market and partners. Partners are a force multiplier. We are a partner-oriented company with a long history of success with best-in-class companies such as SAP, Salesforce, Microsoft, Global System Implementers and many more. Some of these relationships are a decade strong. In early 2019, we announced a partnership with Google. We expanded that relationship over the summer, have begun to see meaningful traction in the marketplace. We have a talent culture to make partners successful, and we'll continue this track record of success with Carbonite.

Let me spend a moment on this. Craig Stillwell has joined OpenText's leadership team as Executive Vice President of SMB and Consumer from Carbonite, where he was the Chief Revenue Officer, and Craig will report to me directly. Craig brings decades of experience in partner and commercial sales, most notably from Citrix. One of the keys to Carbonite's success is the ability to deliver a high-value product at low incremental cost through their cloud platform to 300,000 SMB customers. We see significant opportunity to enhance the breadth and depth of their products, improve profitability and expand geographically beyond the company's predominantly U.S. market. I talked about this as one of the value plays we'll pursue.

Ted Harrison, of course, will continue to lead our enterprise sales business, reporting to me, targeting the Global 10,000, which includes the 10,000 largest organizations, governments and companies in the world. We remain committed to doubling our G10K coverage from 40% to 80% in the next 3 years through both direct sales and partnerships. Let me emphasize from our Investor Day, any margin gains above 40% will be reinvested to drive sales growth across enterprise and SMB.

We recently added a new global account management organization, for example, within the enterprise to provide laser focus on our top enterprise customers. One enterprise team can focus on the enterprise customer. Carbonite SMB and consumer channel can focus on SMB and the consumer as we leverage these new routes to market. We now have complete go-to-market coverage. The more we can connect a customer to an OpenText product, the more we win.

Let me transition a little bit to the M&A environment. Before we touch on the wider M&A environment, I'd like to point you to the strong liquidity and balance sheet slide and the Q2 FY '20 financial and business results presentation on our website. Our strong cash flows enabled us to rapidly pay down debt incurred by the Documentum acquisition, and we expect to repeat this with Carbonite to reduce our net leverage ratio from 2.3x today to less than 2x within the next 4 to 5 quarters.

Now for the M&A environment, now we see an extended market period of modest global growth, low cost of capital in a volatile macro environment due to geopolitical and trade disruption. In times such as these, companies tend to shed assets. This creates an opportunity for patient and strategic acquirers like OpenText. Carbonite represents our 9th cloud acquisition, including EasyLink, GXS, Recommind, ANX, Covisint, Hightail, Catalyst and Liaison. We have a proven track record of success. We remain committed to acquiring value-based assets and unlocking value using the OpenText Business System. It is this discipline that has enabled us to acquire 9 cloud companies at value prices and deliver high teens ROIC. Our primary focus is on the successful accretive integration of Carbonite, and getting it on our target model by the end of fiscal '21 or sooner.

At the same time, we still have an active pipeline of opportunities we are evaluating. We'll continue to be an opportunistic, strategic acquirer, while we build out our information management platform.

I'd like to turn to and emphasize the word durable from our Investor Day in September, the durability of the OpenText operating model and our financial outlook, both short and long term. As I spoke earlier about 20 consecutive quarters of year-over-year total growth, 20 consecutive quarters of year-over-year cloud revenue growth, our [year-to-date] (added by company after the call) annual recurring revenues now represent [76%] (corrected by company after the call) of total revenue, up from 65% from a few years ago and expanding. Our customer support renewals are in excess of 90%, and our cloud renewal rates are in the mid- to high 90s. Our trailing 12-month operating cash flow is $860 million, and Carbonite will further the predictability of our business. This is the definition of durable.

Let me get on to the macro and our quarterly factors. We are expecting -- against our quarterly factors, we're expecting low double-digit revenue growth in Q3 fiscal '20 on a year-over-year basis. This includes Carbonite and FX. Non-GAAP total operating expenses to be approximately 30% higher in Q3 fiscal '20 on a sequential basis than Q2 fiscal '20 of $286.1 million. And Q3 fiscal '20 adjusted EBITDA dollars to be flat to slightly up on a year-over-year basis. You'll see all these items presented in the quarterly factors section of our investor materials. We view our business annually.

For the full fiscal year '20, inclusive of Carbonite and FX, let me update you on our business targets. Expect $195 million to $200 million of new Carbonite revenues for the second half of fiscal '20. And this is after PPA or purchase price adjustments and any typical disruption factor as we integrate the business. Year-over-year license growth in the low mid-single digit. Year-over-year cloud growth in the low to mid-20%. Customer support, constant to low single-digit growth. Professional services, constant dollars year-over-year and margin expansion, positive organic growth, positive OCF growth, year-over-year increase in adjusted EBITDA dollars, year-over-year increase in adjusted EPS, and Carbonite will be accretive to adjusted EPS this fiscal year. And I'm pleased to confirm that we're on track to meet our fiscal '22 aspirations of adjusted EBITDA and OCF, that's 38% to 40% adjusted EBITDA and $1 billion to $1.1 billion of operating cash flow.

As a reminder, and as previously you had highlighted, we plan to discuss any fiscal '21 targets once we complete fiscal '20. And conjunctive with that, we'll communicate our annual dividend approach now aligned to our fiscal year.

Turning to the changing global macro environment and our quarterly factors, we have highlighted a few areas in our investor presentation that have the potential to impact customer spending environment. Global recession concerns, trade and tariff floors, Europe and U.S. manufacturing slowdown, the coronavirus as well as the Gulf nations and the pending Brexit.

While we have not seen any material impact to our business due to macro-related factors, and our business in China is de minimis, we all read the same newspapers, remain mindful of global events. Despite the macro environment, we remain confident and ready for any economic environment with our durable business model. We are poised to capitalize on the structural shifts in global trade. U.S. dollar remains -- the U.S. dollar remains strong compared to other currencies, and this has caused a short-term FX revenue headwind. In Q2 fiscal '20, the FX revenue impact was a negative $10.2 million, and we continue to expect the total FX revenue impact of negative $35 million to our revenues in fiscal '20.

As a reminder, over 50% of our revenue and profits are in the U.S., and Carbonite's revenues are U.S.-centric. And in the investor materials, you'll see 58% of total revenues are from the America. On the earnings front, OpenText continues to utilize balanced and natural hedging and our cost structure that reduces FX volatility in earnings.

Let me summarize. In summary, I want to reinforce that the company is focused and ready for all scenarios. The continued adoption of hybrid cloud by our enterprise customers are gaining share with our upcoming cloud additions. Winning the cyber resilience in the SMB consumer markets, widening our aperture to include the intelligent edge. We're well positioned to capture our existing information management share, both in the United States and globally. And we are the market leader in content services and business networks and a rising leader in cybersecurity. We are a patient and disciplined strategic acquirer. OpenText is part of a new generation of cloud companies inventing the future of business, and we have a once in a 20-year opportunity to help our customers migrate to the cloud, reinvent their business processes and provide secure and resilient platforms from endpoints through to identity.

I'll end my prepared remarks here. And with that, it's my pleasure to turn the call over to Madhu Ranganathan, OpenText's Chief Financial Officer. Madhu?

Madhu Ranganathan - *Open Text Corporation - Executive VP, & CFO*

Thank you, Mark, and thank you all for joining us today. First of all, a huge welcome to all members of Carbonite. The OpenText and Carbonite teams worked diligently together to close the second quarter, and our integration is commenced with strength. We closed Carbonite on December 24. And during the 8 days in Q2, Carbonite contributed $9.5 million in revenues and a net loss of $3.7 million on a GAAP basis, primarily on account of intangible amortization and onetime fees of special charges. Carbonite was accretive on a non-GAAP basis. As we turn to the details of our quarterly results, all financials discussed are inclusive of Carbonite's 8 days of contribution. Please note that our updated fiscal '20 target model is included in our Q2 investor presentation posted on the IR website and will be addressed in my comments. Our long-term fiscal '22 aspirations remain unchanged. Similar to prior quarters, my references will be in millions of USD and compared to the same period in the prior fiscal year.

And let me start with revenues and earnings. Total revenues were $771.6 million, up 4.9% or up 6.3% on a constant currency basis. Foreign exchange continues to be meaningful. There was a $10 million FX negative impact to revenue in the quarter. Year-to-date, total revenues were $1.5 billion, up 4.7% or up 6.1% on a constant currency basis.

Earnings per share. For the quarter, GAAP earnings per share diluted was $0.40 and up from $0.39. And in the quarter, non-GAAP earnings per share diluted was $0.84, up from $0.80 or up $0.06 on a constant currency basis. On a year-to-date basis, GAAP earnings per share diluted was $0.67, up from $0.52 and primarily due to increase in revenues. Year-to-date non-GAAP earnings per share diluted was $1.48, up $0.08 or up $0.11 per share on a constant currency basis. The geographical split of revenues of total revenue in the quarter was Americas, 58%; EMEA, 33%; and APJ, 9%. Annual recurring revenues were $563.8 million, up 6.5% or up 7.8% on a constant currency basis. Year-to-date annual recurring revenue was $1.1 billion, up 6.1% or up 7.4% on a constant currency basis. Annual recurring revenues as a percent of total revenues was 73% for the quarter, up from 72% in the prior year and 76% year-to-date, up from 75% in the prior year. Our cloud revenues are particularly strong at $248.3 million, up 13.3% or up 14.1% on a constant currency basis. Year-to-date, cloud revenues of $485.6 million, up 13.6% or up 14.5% on a constant currency basis. Our customer support revenues were $315.5 million up 1.7% or 3.3% up on a constant currency basis. Year-to-date, customer support revenues were $627.8 million, up 0.9%, and are up 2.6% on a constant currency basis. Our customer support renewal rate was up slightly to approximately 93% from 92% last quarter. Our license revenues were $138.1 million, up 4% or up 5.6% on a constant currency basis. Year-to-date, our license revenues were $216 million, up 3% or up 4.6% on a constant currency basis. Our professional services revenues were $69.6 million, down 4.5% or down 2.9% on a constant currency basis. Year-to-date, professional services revenues were $139 million, down 3.1% or down 1.4% on a constant currency basis.

Turning to margins. GAAP gross margin was 69.9%, up 90 basis points. Year-to-date, GAAP gross margin was 68.6%, up 100 basis points. Our adjusted gross margin was 75.5%, down 20 basis points. Year-to-date, adjusted gross margin was 74.4%, also down 20 basis points. During both periods, adjusted gross margin is well within the range of our fiscal '20 target model.

Also, on an adjusted basis, cloud margin was 58.4% a 130 basis point improvement from Q1 fiscal '20 but down from 59.7% last year. Year-to-date, cloud margin was 57.8%, down from 58.9%. Our customer support margin was 90.7%, up from 90%. Year-to-date, customer support margin was 90.7%, up from 90.2%. Our license margin was 97.8%, up from 97.2%. Year-to-date, license margin was 97.5%, up from 96.4%. Our professional services margin was 23.5% and consistent with last year. Year-to-date, professional services margin was 22.8%, up from 22%. Adjusted EBITDA was $317 million, up 2.8% or up 4.9% on a constant currency basis. Margin-wise, this represents 41.1%, down slightly compared to 41.9% last year. Year-to-date, adjusted EBITDA was $571.2 million, up 3% or up 4.9% on a constant currency basis. Margin-wise, this represents 38.9%, down slightly by 60 basis points. Our adjusted net income was $227 million, up 5.2% or up 8.1% on a constant currency basis. Year-to-date, adjusted net income was $400.5 million, up 6.1% or up 8.8% on a constant currency basis. GAAP net income was $107.5 million, up 2.9%. Year-to-date, GAAP net income was $181.9 million, up 29.2% and primarily due to increase in revenues.

Turning to operating cash flows. It was $207.2 million, an increase of 9.6%. Year-to-date, operating cash flows were $344.7 million, down by 4.4%. Our collection efficiencies remained strong with our current quarter DSO at 57 days lower by 2 days compared to Q2 fiscal '19. Improving all aspects of working capital efficiency for OpenText and Carbonite will be a key focus for us.

Balance sheet. From a balance sheet perspective, we ended the quarter with approximately $675 million in cash compared to approximately $999 million in Q1 fiscal '20, down in a large measure due to cash used to complete the Carbonite acquisition. And looking back, our efforts to build balance sheet strength over the past several fiscal years have paid off. Our consolidated net leverage ratio was 2.3x. We also remain confident in our ability to bring our net leverage ratio down below 2x in the next 4 to 5 quarters.

The acquisition of Carbonite, as mentioned, on December 24, 2019, we acquired Carbonite for $1.4 billion, financed by cash on hand and our existing revolver. We have recorded a $75 million deduction in Carbonite's deferred revenue as purchase price allocation adjustment. I will refer you to the slide, called Carbonite Update and Revenue Impact in our Q2 Investor Relations presentation, posted on our website and in our 10-Q for further details.

For the second half of fiscal '20, we expect Carbonite revenue to be between $195 million to $200 million after PPA and typical business disruption of up to 10% due to integration activities. As a reminder, we expect Carbonite to be on our operating model by the end of fiscal '21.

Carbonite integration and restructuring plan. We are committed to a thoughtful and fast integration of Carbonite into OpenText. Carbonite will be accretive during fiscal '20. We expect the integration to be completed by the end of fiscal '21 or sooner. Today, we're announcing a restructuring plan that integrates Carbonite into OpenText and also into streamlining operations at OpenText. The anticipated cost is expected to be approximately $26 million to $34 million. These restructuring activities are anticipated to be completed by the end of fiscal '21, and once completed, OpenText anticipates annualized cost savings of approximately $37 million to $41 million. We expect any savings realized during the remainder of fiscal '20 to be largely offset by onetime Carbonite integration costs, with the majority of the financial benefits to be realized in fiscal '21.

Our fiscal '20 target operating model and long-term aspirations. We're executing well to our business plan. The impact of restructuring have been considered in the fiscal '20 target model framework that we're sharing with you today. We highlight the following changes. With the acquisition of Carbonite, we have increased the contribution of cloud revenues from 31% - 35% to 34% - 38%. We expect 100 basis point increase in our annual recurring revenue range of 75% to 77%. We're also increasing the fiscal '20 target model ranges for non-GAAP cloud gross margins to 58% to 60%. We expect Carbonite to be accretive and increase the adjusted EBITDA dollars. This is reflected in the adjusted EBITDA margin range of 36% to 37% in our fiscal target model. Please refer to our IR deck for further details of other aspects of our target model.

Our fiscal '22 aspirations. We remain on track to meet our fiscal '22 long-term aspirations. Our current fiscal '22 aspirations include 38% to 40% adjusted EBITDA with margins above this range reinvested for future growth, including product, sales capacity, partners and marketing, $1 billion to $1.1 billion operating cash flows during fiscal '22. With the inclusion of Carbonite, we see upside opportunities to our operating cash flows, which we will update during our annual fiscal '20 earnings call.

Our quarterly factors. And let me summarize here and reiterate the quarterly factors that we anticipate for our upcoming Q3. I would emphasize a few items. As we look at where FX rates are today as well as a geographical component of our business, we note that the FX headwind for the first half of fiscal '20, was $20 million to revenues. We continue to expect that approximately $35 million annual FX headwind for fiscal '20, inclusive of Carbonite. And furthermore, inclusive of Carbonite, we expect low double-digit revenue growth in Q3 on a year-over-year basis. Expect non-GAAP total operating expenses in Q3 to be up approximately 30%, compared to Q2 fiscal '20 of $286.1 million as we included a full quarter of Carbonite's operations and seasonal increases relating to our annual performance cycle. Our adjusted EBITDA dollars to be flat to slightly up on a year-over-year basis.

A tax update with respect to the IRS matter. We remain in the appeals space. The standard IRS process continues, and our resolve remain strong as we vigorously defend our position.

Dividend. Turning to our dividend program. Today, we announced a quarterly dividend of $0.1746 per share payable on March 20, 2020. Our rate is based on distributing approximately 20% of our trailing 12-month operating cash flows. And to reiterate, our annual dividend approach will be communicated following our fiscal year-end.

In summary, we are pleased with our Q2 results. We have kicked off an integration of Carbonite with strength and remain focused on our fiscal '20 and long-term targets.

And finally, I'd like to thank you, our shareholders whose trust and confidence we greatly value, and the OpenText team for their deeply committed efforts.

And now I would like to turn the call over to the operator for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Raimo Lenschow of Barclays.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

I had a couple of quick ones. First, Mark, can you -- so we owned Carbonite for like a bit over a month now. Can you just see what your strategy around cyber resilience? What was the initial customer feedback that you've seen so far?

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

Yes, thanks for the question. The feedback has been amazingly positive. The -- it's a very natural extension to want to provide in our information management strategy the protection and resiliency of information, not just the kind of the management of it in content services or the exchange and connectivity of it through business network but now to be able to provide data protection and security and threat intelligence around it. So I'd say, extremely positive. And it's a very talented workforce. We love the channel that they have built. The cultures are coming together very nicely. And we have opportunities both ways. We have product to be able to provide the SMB channel from OpenText and the ability to take data protection and BrightCloud into the enterprise. So when things are natural, they tend to come together.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

Okay, perfect. And then the quick other question because you're kind of, obviously, one of the very large of the larger leading software vendors, like -- and you have like a bigger global footprint than other people. What are you seeing in terms of end demand out there because a couple of quarters, that was something that you highlighted? If I look at the results, it looks like everything is kind of going well out there.

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

Yes. It's -- as I said in my remarks and sort of our quarterly factors. We're expecting positive organic growth this year on an annual basis. The M&A environment continues to be healthy for us in building pipeline. But the hotspots around the world sort of continue to include manufacturing. You got to be -- continue to watch trade and tariffs. It's a bit unpredictable. And though our business is a little -- is de minimis in China, obviously, we're all watching the coronavirus very carefully and how that might affect travel, transportation and a few other sectors. But if we look at our results of total revenues up near 5% in reported and near 7% in constant currency, we're seeing a stronger demand for digitalization in our solution.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

Okay. Perfect. And then one last question. And Madhu, cash flow was very -- operating cash flow was very strong this quarter. Were there any particular drivers you wanted to point out to?

Madhu Ranganathan - *Open Text Corporation - Executive VP, & CFO*

I mean as I said in my comments, we continue to improve sort of the working capital framework. Our DSOs were 2 days lower than prior year. And you should sort of expect to see that gradual progress as we get into fiscal '20 and '21 as well.

Operator

Our next question comes from Daniel Jester of Citi Bank.

Daniel William Jester - *Citigroup Inc, Research Division - VP*

So Mark, you mentioned in your prepared remarks about the 24-city cloud tour that you hosted this fall. I'm just wondering if you could share with us some of the feedback you got from that. And specifically, I'm wondering if you learned anything that revises kind of your expectations for the Cloud Edition launch later this year.

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

Yes, thanks for the question. We're just reflecting back over 7 years of growing from 0 cloud revenues to the incredible scale we have today and looking back, it's a 30% CAGR over near 7 years, the quarter up 14%. And we kind of revised upwards our 20 -- our fiscal '20 view to where we're going to see about 20%-plus growth in the cloud. The cloud tour was about a part of our cloud, which is our managed services. And that's primarily what the cloud tour was about, about the enterprise and about managed services. And it just reinforces that in the enterprise, we differentiate on being able to allow customers to get their competitive advantage by really tailoring software to their needs, both in the business network and in content services. We have those things that are more standard via SaaS, like Core and our new e-signature offering, and there are things even more standard, right, that's going to be at more volume through SMB. But specifically to the question, the cloud tour was really about Managed Services. Having customers migrate from off cloud to the OpenText cloud, and we have thousands of customers today that run off cloud. And what we learned is continue to stay on your hybrid strategy and Managed Services has a big role in the OpenText future.

Daniel William Jester - *Citigroup Inc, Research Division - VP*

Great. And then just a follow-up. One of the points you stressed a lot in your tech today was about the durability of the business model and how the acquisition of Carbonite has made you more durable. Does that change how you view your balance sheet? You also sound pretty positive about the M&A environment. So given the increased durability of the business, would you look to deploy your balance sheet differently in the future?

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

Yes, yes. Thanks for the question. Yes, our -- we are all about annual recurring revenues, whether it comes from the cloud or comes from maintenance, right? And they really -- they both have similar durability, high longevity, high renewal rates, great margin. So it's cloud or very recurring maintenance. And that's what we like in the durability.

Now that becomes -- as cloud grows and ARR grows, the predictability of our business gets a little better every quarter, gets more better, if that's proper English, yes, every year, year-over-year. And you can see that percent increasing. There's a few years ago, we're in the mid- to low 60s, we're in the mid-70s this year, we'll creep up into the mid- to high 70s next year. So we really like that predictability.

We're also a patient deployer of capital. We're sitting at about 2.3x ratio. We'll be back under 2x in 4 to 5 quarters, but we're going to remain strategic. We're going to remain patient. And right now, over the next quarter to 2, the most value we can unlock is via the Carbonite integration. Getting Carbonite, Webroot integrated, getting them integrated into OpenText, initiating and completing our restructuring plan, growing their SMB channel. Getting Europe up and running and getting a couple of wins in the OpenText enterprise. And that's really where the most value we can unlock right now over the next 1 to 2 quarters.

Operator

Our next question comes from Richard Tse of National Bank Financial.

Richard Tse - *National Bank Financial, Inc., Research Division - MD & Technology Analyst*

Yes. I was wondering if you need to do anything with the prior portfolio to sell into the SMB channel. Obviously, it seems like Carbonite is bringing a pretty extensive channel there. And I'm kind of curious to see whether you need to rejig the products in any way.

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

Richard, it's Mark. Thanks for the question. Thanks for joining the call. At present, we're going to -- the focus is to look at a handful of solutions that's currently in our portfolio and get greater distribution through the Carbonite channel.

Take a couple of examples, a few examples. First is EnCase. We bring digital forensics to the enterprise. But the product is built for law enforcement organizations, which look a lot like SMB organization. So in the first half of calendar '20 here, right? We got Carbonite focused on Carbonite. They'll then pick up EnCase and bring that into the SMB market. We also have EasyLink solutions that have historically been a portion of which is SMB oriented. So EnCase product, ready to go. EasyLink, ready to go. Hightail, I think, will benefit as well from that channel.

So Phase 1 is, the most value we can unlock is getting the Carbonite integration complete. And getting that kind of well established. Second is to bring existing products that we have to the channel. And I think products as core and e-signature grow and mature, I think it will be a very natural fit for the high end of SMB and for the enterprise as well, which would be a little more like a Phase 3.

Rich, I hope that's helpful.

Richard Tse - *National Bank Financial, Inc., Research Division - MD & Technology Analyst*

Yes. It makes a lot of sense. So I guess, maybe in a related question, with respect to one of the initiatives you talked about at your Investor Day in the fall. In regards to targeting the Global 10,000, can you maybe give us a progress update in terms of where you are there?

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

Yes, we don't have a specific count today, except to say that we expect to have our coverage doubled in -- I think, near 2/3 of the G10K covered over the next 10 years. One piece of update I did provide today is we put a new global account management team in place recently. And that team is fully in place, operational. We brought a couple of existing we recast, if you will, some of our great internal talent. We went outside and brought some new talent in. We have a great leader, Benoit, out of Paris, leading this group for us. And we're targeting our top 100 accounts, and just giving those top 100 accounts a laser focus. One sort of account executive to manage all the opportunity across the General Motors, for example, or across a British Petroleum, as examples. So we're marching towards near 65%, 70% coverage over the next 2.5 years or so from -- when we stated that goal. And one big step was putting that global account management team in place, which is now established.

Richard Tse - *National Bank Financial, Inc., Research Division - MD & Technology Analyst*

Okay, great. And just one last quick one for me. There's no doubt you've got the capacity financially to do more acquisitions here. Do you have the capacity to do it from a management personnel perspective? And maybe sort of what's your willingness to sort of do more acquisitions over the next 12 months, considering that you just closed Carbonite?

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

Yes. It's -- well, the financial capacity is certainly there. We've set up the integration of Carbonite. We think this has an opportunity to talk a bit about the integration of our new SMB consumer group in a little language, if you will. We think Carbonite that was a public company, of course. We think there are 2 strong -- 3 strong product lines here. Carbonite, Webroot and BrightCloud. Those are 3 product lines underneath the Carbonite banner.

The enterprise team is unaffected by this integration. Craig is reporting to me directly, Hal Lonas, great engineer reporting into Muhi, and all the back offices are direct line in -- HR to HR, finance to finance, legal to legal, IT to IT. So the enterprise team is unaffected by this, except that they're going to get more products to sell. So there's bandwidth on the enterprise side. But right now, over the next couple of months and quarter or 1.5 quarter, the greatest value we can do is to unlock those value plays inside of Carbonite. But we'll note it, we get the balance sheet. We continue to work top of pipeline. Companies tend to shed assets in environments like this, and I'll note that the enterprise team is really unaffected by Carbonite -- structurally unaffected by the acquisition and integration.

Operator

Our next question comes from Thanos Moschopoulos of BMO Capital Markets.

Thanos Moschopoulos - *BMO Capital Markets Equity Research - VP & Analyst*

Mark, with respect to the restructuring, you mentioned that part of it will be for streamlining the business outside of Carbonite. I thought you were already running quite a tight ship. So could you expand on what you'll be doing there?

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

Yes. It's -- I've always appreciated the Snapple logo, which is the best things on Earth, keep getting better. So we do run a tight ship, as you well know, but you also need to challenge yourself to keep getting better.

And so the restructuring is sort of 2 parts. The first part is completing the acquisition of -- into completing the integration of Carbonite, Webroot and integrating that into OpenText. Well studied, very thoughtful, we believe in quick integration and quick cost out. And here we are in January, really, 30 days, 35 days after the acquisition, and we got our plans defined and announced.

The other part of this is, in looking at how we would integrate Carbonite into OpenText, we have some opportunities to leverage better our centers of excellence. Carbonite had outsourced parts of engineering in India, had outsourced support to a third party. And through that aperture, we're able to scale up a little more, India, Philippines, Canada through our centers of excellence, but took this as an opportunity to look across OpenText and complete some of those opportunities.

Thanos Moschopoulos - *BMO Capital Markets Equity Research - VP & Analyst*

Great. And then in terms of -- on the M&A front, you established the portfolio group recently. I saw that you did a small buck in this quarter. Can you update us in terms of the pipeline of smaller deals you're seeing and the cadence that we might see there?

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

Yes. We're remised to not mention in our prepared remarks, the Fax guys that we acquired. And that was a reseller of our fax business, primarily in the U.S., great style acquisition for us. A known entity, a good -- small but solid add of new revenues. It will actually -- it's small, but it will exceed the corporate ROIC. It will have a high return on invested capital. And those are the type of deals we're looking to do through OPG or the portfolio group. So they're building a very robust pipeline, and we'll get OPG deals done here in calendar '20. So just watch the space, we'll get deals done here in OPG in fiscal '20 -- calendar '20.

Operator

Our next question comes from Paul Treiber of RBC Capital Markets.

Paul Michael Treiber - *RBC Capital Markets, Research Division - Director of Canadian Technology & Analyst*

Just was hoping you could follow up on your last comment just on the integration plan for Carbonite. At a high level, how does the plan -- your game plan differ from prior acquisitions, particularly in light of the SMB and consumer channel that they have? And what do you see as the biggest opportunities and then potentially also the potential challenges that you may need to address with it?

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

Yes, Paul, thanks for the question. So 3 parts in there. The first is perhaps how does this differ than previous integrations. So on the kind of supporting operations, finance, HR, IT, traditional back office doesn't differ at all. It's straight-line integration, functional integration.

What's different is we're really keeping a go-to-market group together under Craig and having him report to me directly. Our integration philosophy is really to integrate at the business unit level and to gain that go-to-market strength. So Craig's organization is a complete organization. They own their demand generation. They own their presales. They own sales, are going own support as well. The support's deeply integrated into the process. So Craig's organization has a slightly wider scope and really owns that SMB and consumer go-to-market.

So coming out of the gate here, we're going to keep this more as a sort of general management group business unit going to market. Hal, who's going to lead engineering, who's going to report directly into Muhi. And look, we're serious about cyber resilience, and we're serious about the edge, and we're serious about SMB. And just like we did in Content Services, where over 25 years, we completed near 60 acquisitions. And in the Business Network, we've completed near 15 acquisitions, and you can expect us to deploy capital and innovate in this group as well. So the plan is just slightly different, where we're having a wider scope of responsibility with Craig as we set up the SMB group.

Opportunity, right? There's opportunity to expand their OEM group and BrightCloud. I'm very excited about brightcloud.com and what that can bring. They're just getting started in MSPs and RMMs, roughly 16,000 out of a total market opportunity of 60,000, international expansion. And then very select but high-power value place to bring into the enterprise like data protection, file integrity and the OEM opportunity.

Challenges. It's minimizing disruption. And talent, right? We've got a -- it's still a war on talent, and we've got to keep fighting for the best people and high retention rates.

Operator

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

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

All right. Well, our prepared remarks were longer than usual tonight, but we had a lot we wanted to communicate. So Madhu and I thank you for joining our call this evening. And I hope you have a great evening. So thank you very much.

Madhu Ranganathan - *Open Text Corporation - Executive VP, & CFO*

Yes. Thank you all.

Operator

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