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OTEX.TO - Q4 2019 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported FY19 total revenues of $2.87b, GAAP net income of $285.5m and GAAP diluted EPS of $1.06. 4Q19 total revenues were $747m, GAAP net income was $72m and GAAP EPS was $0.27.

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PRESENTATION

Operator

This is the conference operator. Welcome to the Open Text Corporation Fourth Quarter and Fiscal Year 2019 Conference Call. (Operator Instructions)

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

Harry Blount - *Open Text Corporation - SVP of IR*

Thank you, operator, and good afternoon, everyone. On the call today is OpenText 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 two presentations that will supplement our prepared remarks today. The first is our strategic overview titled OpenText Investor Presentation. The second, titled Q4 and F2019 Financial and Business Results, includes information and financials specific to our quarterly and FY2019 results, notably our updated quarterly factors on Page 9.

In August and September, OpenText management is looking forward to meeting with investors in Canada and the United States. We'll be attending the KeyBanc Technology Leadership Forum on August 12, in Vale, Colorado, as well as the Citi Technology Conference on September 5, in New York. Please feel free to reach to me or the Investor Relations team directly for more information.

And now I'd like to tell you about an exciting event coming up for OpenText. OpenText is pleased to announce that we will be participating in the NASDAQ Opening Bell Ceremony at the NASDAQ marketsite in New York's Times Square on September 5. The event will be live-streamed at 9:20 a.m., on the Investor Relations website.

And finally, I'd like to remind institutional investors and equity analysts, that OpenText will be hosting Investor Day on the morning of Friday, September 6, at the Lotte New York Palace. This event will consist of our annual investor update, featuring strategic presentations from key members of our executive leadership team. Please contact investors@opentext.com to RSVP and confirm your attendance. For those unable to attend, presentation material, as well as listen-only teleconference and audiocast will be publicly available on the Investor Relations website.

And now I will proceed with the reading of our safe harbor statement. Please note 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 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, which may also 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'm going to hand the call over to Mark.

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

Thank you, Harry. Good afternoon to everyone and thank you for joining today's call. I'm pleased to announce record OpenText fiscal 2019 results. If there is one word to describe OpenText, it is durable - long-lasting, well-made, sustainable. Durability stems from a business model centered on value creation in up or down markets, in stable or volatile times. We delivered record results in markets that are increasingly volatile. Just look at the U.S. news today on another 10% China tariff and the hard Brexit discussions last week in England.

OpenText's results are built with the continued trust from our customers and places the company in a great position for the years ahead. We are a company focused on total growth, cash returns and disciplined value creation.

Let me speak to this bigger picture before I get into the shorter term. In constant currency, we finished fiscal 2019 at $2.92 billion in total revenues, up 4% year-over-year. Our cloud revenues grew by double digits to $918.6 million, up 11% year-over-year. Our organic growth was positive, but under 1% for the year. And ARR grew organically by 1.5%.

Our growth would have been even higher if not for the short-term external effects of a strong U.S. dollar, trade wars, tariffs and a temporary slowdown across Asia.

Q4 revenues were affected by $22 million due to foreign exchange and $53 million for the full year. I'll have more to say on growth in a few minutes.

As reported, our adjusted EBITDA dollars were $1.1 billion or 38.4%, up 210 basis points year-over-year. Operating cash flows were $876 million, up 24% year-over-year. Our ending cash balance was $941 million. And we had a net consolidated debt ratio of 1.5x. This is growth and value in all the right places.

The clear headline for fiscal 2019 is record total revenues, record cloud revenues, record adjusted EBITDA dollars and record operating cash flows, built with the trust of our customers and the expertise and excellence of our employees. This momentum continues into fiscal 2020, and our priorities remain consistent - total growth, cash flow expansion and disciplined value creation.

I'd like to highlight a number of achievements since our last call. We announced a broader and deeper relationship with SAP. We are the defacto content services platform for the largest business software company in the world off cloud and now in the cloud. We announced a deeper relationship with Google. We are now their preferred partner for enterprise information management services for the cloud. We announced a strategic relationship with MasterCard for the cloud, to help companies increase financial efficiencies across global supply chains, starting with the automotive industry. The collaboration will better enable companies, irrespective of size or location or technical capability, to build increased trust and security into trading partner relationships.

I also want to thank Coca-Cola, Intel, Citibank and the South African National Parks for joining us at Enterprise World and sharing their respective transformative journeys leveraging OpenText technologies. The most trusted companies trust OpenText.

We announced a Cloud-First world with OpenText Cloud Editions, OpenText Business Network and OT2 services. Fiscal '20 represents for OpenText that Cloud-First approach and an enhanced product cycle for the second half of fiscal '20.

We also had some major customer wins in the quarter that you can see in our investor materials, including Core-Mark, BMW and others. Here I'd like to highlight Vertican Technologies. They are the market leader in end-to-end collections. They will be standardizing our Business Network technology to digitize and make everything machine-readable, the end-to-end collection process from sourcing to collections to payment to final resolution, including integration to court systems.

The enterprise software landscape has changed, and our competitive position has never been stronger. We enter fiscal 2020 recognized as leaders by Gartner, Forrester and IDC in our core markets of content services and business networks, and we were recently recognized as a leader in the developer community with AppWorks. Said differently, OpenText is the standard for organizing, storing and moving critical data throughout and between enterprises.

Our Magellan product puts us in a strong position to extend our leadership into helping our customers mine their data for actionable insights and EnCase puts us in a position to secure it.

OpenText's total growth strategy is a powerful trifecta of three motions - retain, grow and acquire. Over the last 5 years, our CAGR for revenues, or cumulative average growth rate for revenues is 12%. As we plan and execute for the coming years, I'm optimistic and confident that we can continue our strong growth rates, recognizing some years may be up and some years may be down.

Let me expand on retain. We have over 10,000 customers that trust OpenText every day, and that customer trust has created a durable OpenText. By durable, I mean 75% of our revenues are recurring, renewal rates are in the 90s and for the first time our annual support margins topped 90%.

Our net promoter scores are among the best in enterprise software and continue to improve. OpenText's durability is rooted in our great software. And what makes great software? Great employees and great customers.

Let me expand on growth. We have an amazing opportunity within our install base to expand product adoption and migrate customers to the OpenText Cloud. It is now a Cloud-First world, and OpenText is in a marquee position to be a strategic provider of a cloud platform that provides for an information advantage, not just cost reduction. We are planning on both broadening and deepening our coverage within the Global 10,000, and we have a tremendous opportunity to grow our business within our existing customer base and product set. We expect our investments in product and go-to-market programs to create further organic growth. Go-to-market investments include important elements such as sales capacity expansion, our inside sales organization going global and a stronger geographic orientation in Asia, Japan, Latin America, Africa, Middle East and Central Europe. We expect this to expand account coverage and deal coverage and create greater market and customer intimacy.

OpenText is now within an ideal adjusted EBITDA range of 38% to 40%.

We set out to be a productivity leader and we arrived here a bit ahead of plan and with a lot of strength. This is upper quartile performance, and any excess above this range, we intend to use to fund growth and to create more value.

On acquire, we continue to be a strategic and disciplined buyer of companies. In the coming years, M&A will continue to be our leading growth contributor. We run a value playbook, and we will remain patient and prudent buyers. As a strategic buyer of assets, ROIC, return on invested capital, is the most important financial metric of any deal. And in fiscal 2019, we expanded our ROIC to 18.7%. High teens ROIC is an ideal place to be for our business model. Our balance sheet has never been healthier for any level of M&A.

This is a trifecta of total growth - retain, grow and acquire. These are proven elements within the OpenText Business System.

Let me bring this all together. In fiscal '19 in constant currency, we grew revenues 4%. We grew cloud 11%, positive organic growth, though it would have been higher if not for the external factors we mentioned earlier. As reported, we achieved an adjusted EBITDA margin of 38%, operating cash flow of $876 million, ending cash $941 million and a net debt ratio of 1.5x. Our last 5-year growth CAGR between fiscal '14 and '19 is 12%, ROIC of 18.7% and we have strong momentum coming out of Enterprise World and heading into fiscal '20.

Now looking more into fiscal '20, let me provide a few comments on our growth profile. We are planning for another record year of total revenues, record cloud, record EBITDA dollars and record operating cash flow. We expect total growth in the low single digits. This is not factoring in any new acquisitions. Cloud growth rate's expected to be in the high single digits, our license and PS businesses constant year-over-year, organic growth in the low single digits and we are increasing our adjusted EBITDA target range from 36% to 38% to a new range of 38% to 39%.

Looking even beyond fiscal '20, I'm optimistic and confident as well about the outer years. Now we don't give guidance. But we remain on a long-term trajectory of robust total growth, right? The 5-year CAGR is 12%. We'll continue to acquire using the proven OpenText value playbook and the OpenText Business Systems. Five years ago, we were integrating business into a 30% margin company. Future acquisitions will be integrated into a high 30s margin company. We achieve acquisitions far faster in the OpenText Business System than other companies do.

We are planning for organic growth in the low single digits. Some have asked me, why not use market rates? Well, here's why. Market rates are bad indicators, as they include large buckets of unprofitable revenue. Cloud should grow and in the high single digits. And the adjusted EBITDA margin range longer term, we continue to look at 38% to 40%. This is upper quartile performance, and we're right where we need to be. Productivity gains above this range, as mentioned earlier, will be invested back into the business for growth and value creation.

I want to personally thank all our customers, partners and technical experts who joined us for our 2019 Enterprise World events in Europe, Asia and North America over the last few months. Across these three events, we directly connected with thousands of customers and partners. I deeply believe we are now in a post ERP era. Do we really need more process advantage? No. What companies need is to unlock the value of their information to gain the information advantage and, in fact, create new business models and become information companies.

As I discussed in my Enterprise World keynote, if you're an auto manufacturer, are you just a car company or an industry 4.0? Or are you a car company and an insurance company, for example.

OpenText can help our customers move beyond process advantage to information advantage and create new business models based on information and insights. We are all information companies, and this is the future of business.

We operate at scale. We are moving to high-impact quarterly product releases that are Cloud-First, not cloud-only. Off cloud is a strategic platform for OpenText. We are helping customers gain maximum value from their off-cloud investments, expand their usage and value and grow into the OpenText Cloud with new investments and new workloads such as OpenText Cloud Managed Services, OpenText Cloud Editions and OpenText OT2. By the end of fiscal 2020 with OT2, we plan to enable the next generation of EIM platforms by providing and selling SaaS-based services as I discussed in my keynote at Enterprise World.

As a reminder, our business network is already 100% in the cloud. The OpenText 20.2 release is a very important milestone for the company next year, when we'll begin to offer cloud-based EIM services of scale hosted and managed in the OpenText Cloud, services to include Capture, Signature, Archive, Content Management, Output Management and Identity. EIM is designed to help customers create intelligent and connected enterprise and gain that information advantage. We're helping customers unlock the value of their information, manage and secure the growing menace of information sprawl, find and protect their endpoints against hacking, breaching and bad behaviors. We are attaching Identity to everything, and we believe we can enable the circular economy through digital and ethical supply chains.

Let me wrap up my comments. OpenText is a durable company, long-lasting, well-made, sustainable, and the leadership team is humble and hungry and ready for all scenarios in the market.

In closing, even in a seasonally lighter Q1, we will grow year-over-year. The fundamentals of the company are rock solid. We're poised to continue strong cloud growth at upper quartile corporate margins and cash flows. Our products, market recognition and brand image has never been stronger. It's a post-ERP era, and companies do not need more process or process advantage, they need the information advantage, and we are the best EIM partner to provide that.

Let me end my remarks with Q1 quarterly factors. Again, quarterly factors are not long-term strategic factors, rather short-term items to consider in your modeling. Global recession concerns continue - Brexit, Asia and other geopolitical events, trade and tariff wars; look at the headline news this afternoon out of the U.S. But U.S. GDP is slowing per a recent U.S. Bureau of Economic Analyst reports. The BEA came out with reports this week as well. A Q1 seasonality, lighter quarter due to summer vacations, thus, few selling days. Q1 FX headwinds could be as high as $12 million down from $22 million last quarter. And F '20 FX headwinds could be about $25 million. Q1 operating expenses to be down sequentially 4% to 6%. And Q1 adjusted EBITDA to be down sequentially between 100 to 150 basis points.

I thank you for your time and attention today and hope you'll join me and the leadership team at our Investor Day in New York on September 6. I look forward to taking your questions after Madhu completes her remarks. Madhu, over to you.

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

Thank you, Mark. And hello, and thank you all for joining us today. Q4 and fiscal 2019 results reflect an unparalleled year of operational performance, investment in growth, strong expense management and capital optimization.

So now turning to the details of our quarterly and annual results. And similar to prior quarters, my references will be in millions of USD and compared to the same period in the prior fiscal year.

During the fourth quarter and fiscal 2019, FX negative impact was meaningful. You will see the impact of FX across the entire P&L, all revenue segments and our earnings, pointing to upward performance when measured on a constant currency basis.

And let me start with revenues and earnings. On revenues, there was a $22 million negative FX impact during the quarter and a $53 million negative FX impact to revenue for the full fiscal year.

Total revenues for the quarter were $747 million, down 0.9%, or $769 million, up 2% on a constant currency basis. For the fiscal year, total revenues were $2.87 billion, up 1.9% from last year, or $2.92 billion, up 3.8% on a constant currency basis. On earnings per share, GAAP earnings per share for the quarter was $0.27 per share, up from $0.23 per share for the same period last year. For the fiscal year GAAP earnings per share was $1.06 on a diluted basis, up from $0.91 per share in the prior year. Adjusted earnings per share for the quarter was $0.72 on a diluted basis, no change from $0.72 per share for the same period last year, or $0.74, up $0.02 per share on a constant currency basis. For the fiscal year adjusted earnings per share was $2.76, up $0.20 from $2.56 in the prior year, or $2.79, up $0.23 per share on a constant currency basis.

So now let me share with you all the other details of our results. The geographical split of total revenues in the year was Americas 59%, EMEA at 32% and APJ 9%. Annual recurring revenues were $557 million for the quarter, up 4.2%, or $572 million, up 7% on a constant currency basis. For the fiscal year, annual recurring revenues were $2.16 billion, up 4.6% from last year, or $2.19 billion, up 6.2% on a constant currency basis. Annual recurring revenues as a percentage of total revenues remained solid at 74.6% and 75.1%, respectively, for the quarter and for the fiscal year.

Our cloud revenues are particularly strong in the quarter at $242 million, up 11%, or $247 million, up 13.1% on a constant currency basis. For the year, cloud revenues were $908 million, up 9.5%, or $919 million on a constant currency basis, up 10.8%. Our customer support revenues were $315 million for the quarter, down 0.5%, or $325 million, up 2.7% on a constant currency basis. For the year, customer support revenues were $1.25 billion, up 1.3% from last year, or $1.27 billion, up 3.1% on a constant currency basis. Our customer support renewal rate was consistent with prior quarters and prior years at approximately 91%.

Our license revenues for the quarter were $120 million, down 14.4%, or $124 million, down 11.3% on a constant currency basis. Our license revenues for the fiscal year were $248 million, down 2.2% from last year, or $439 million, up 0.4% on a constant currency basis, due to cause that our third quarter had very strong licensed revenues and, in general, license revenues have quarterly volatility and, as mentioned, on an annual basis, our license revenues remained constant.

Professional service revenues were $70 million for the quarter, down 11.7%, or $73 million, down 8.1% on a constant currency basis. For the year, professional services revenues were $285 million, down 9.9% from last year, or $293 million, down 7.4% on a constant currency basis. Our goal as we stated earlier, is to target higher margin PS business and leverage a partner network.

And with respect to ASC 606, in Q4, ASC 606 impact was de minimis. Our details are available in the Form 10-K filed today. The accounting rules require companies to provide comparisons to ASC 605 only during the first 12 months of the year of adoption. Accordingly, Q4 will be our last quarter to report the comparison, and beginning fiscal '20, we will report under ASC 606 only.

Turning to margins. We are very pleased with our margin performance in the quarter and in the fiscal year. GAAP gross margin for the quarter was 68%, up 80 basis points from last year. And GAAP gross margin for the fiscal year was also 68%, up 140 basis points over the same period last year. Adjusted gross margin for the quarter was 74.2%, up 20 basis points over the same quarter last year. For the fiscal year, adjusted gross margin was 74.1%, an improvement of 110 basis points. Also on an adjusted basis, cloud margin was 57.2% during the quarter. For fiscal 2019, cloud margin was 57.8%, up from 56.2% in fiscal 2018.

Our customer support margin was 90.4% during the quarter. For fiscal 2019, customer support margin was 90.1%, up from 89.2% in fiscal 2018. Our license margin was 96.6% during the quarter. For fiscal 2019, our license margin was also 96.6%, slightly down from 96.9% in fiscal 2018.

Our professional services margin was 22.2% during the quarter. The fiscal 2019 professional services margin was 21.8%, up from 20.5% in fiscal 2018.

Adjusted EBITDA was $284 million this quarter, up 0.8% year-over-year. Adjusted EBITDA margin was 38%, an increase of 60 basis points compared to 37.4% in the Q4 last year. For fiscal 2019, adjusted EBITDA was $1.1 billion, up 7.8% compared to the prior year. And adjusted EBITDA margin for the year was 38.4%, an improvement of over 200 basis points compared to 36.2% in fiscal 2018.

GAAP net income for the quarter was $72 million, up from $61.7 million for the same period last year. Our fiscal 2019 GAAP net income was $285.5 million, up from $242.2 million for the same period last year. Our adjusted net income in the quarter was $194.4 million, up 1.1% from last year, or up 4.7% on a constant currency basis. Fiscal 2019 adjusted net income was $744.7 million, up 8.9% compared to the same period last year, or up 10.2% on a constant currency basis.

Now turning to the fiscal 2019 target model. We shared our target model at the start of the year with you all, and you will see that we ended fiscal 2019 solidly meeting expectations of our target model on all elements. Overall, our adjusted EBITDA margin for the year was 38.4% above the target model range of 36% to 38%, and reflecting a very deep operating lens that we place on all aspects of our business, large, medium or small.

Turning to operating cash flow for the quarter, we generated $230 million, up 12.6% year-over-year. During the fiscal year, our annual operating cash flow was a record $876 million, up 23.8% year-over-year. Our performance reflects a cash flow engine built well, to be optimized continually and support OpenText in the required operating investments for our total growth initiatives.

And let's turn to the balance sheet. We ended the year with $941 million in cash, a 37.8% increase year-over-year. Our consolidated net leverage ratio at 1.5x is the strongest level in 2 years and well within our external debt covenant ratio of 4x.

In terms of the ongoing IRS matter, I refer you back to Mark's comments on our last call. The standard IRS process continues as we head into the appeals phase. Our resolve remains strong as we vigorously defend our position.

And turning to dividend. Our dividend program continues to be a very important component of our capital allocation strategy, and today we announced a quarterly dividend of $0.1746 per share. As a reminder, our dividend rate is based on distributing approximately 20% of our trailing 12-month operating cash flows. Going forward, our dividend rate will continue to be assessed annually, with the next update occurring this time next year, to align with our fiscal year performance.

Turning to organic growth and ROIC. At the start of the year, we provided two metrics that we agreed to update at the end of each fiscal year on a historical basis - annual organic growth of total revenue and return on invested capital, ROIC. These have been included in the investor materials we posted on our IR website today.

For the year and in constant currency, total organic growth was positive, but below 1%, which was impacted by the external factors that Mark highlighted earlier. Annual recurring revenue grew organically in constant currency at 1.5% during fiscal 2019. Our return on invested capital, ROIC, was 18.7% compared to last year of 17.5%, given higher profitability.

So let's turn to fiscal 2020 target operating model and our long-term aspirations. So today we published our fiscal 2020 target model, which, as a reminder, is included in our investor presentation on our website. And consistent with our practice, the fiscal 2020 target model provides annual ranges to our operating model. Please do refer to Mark's commentaries earlier as he talked about the components of our total growth. It's retain, grow and acquire.

As you look at the share of revenue segments to total revenue in our target for fiscal '20, the full year impact on revenue, for Catalyst and Liaison acquisitions is expected to increase the Cloud Services and Subscriptions range from 28% to 32%, to 31% to 35%, with the offset in the customer support range of 42% to 46%, to 40% to 44%.

As we built out target model for fiscal '20, we maintained our fiscal '19 margin and expense ranges across all elements of our model, while we shifted upward our adjusted EBITDA range from 36% to 38%, to 38% to 39%, moving the low end up by 200 basis points and the high end up by 100 basis points.

We have been and continue to remain focused on profitable growth. Our focus in growth will also be in the right places, such as our cloud.

An update on interest and adjusted tax rate. Our fiscal '20 target model for interest expenses remains at $140 million to $145 million, and adjusted tax rate also remains at 14%. Our fiscal 2022 aspirations, as you can see, we are shifting our 3-year target range to fiscal 2022. Our long-term aspirations now looking at fiscal 2022, will be 38% to 40% adjusted EBITDA, with margins above this range reinvested back into the business for growth and value creation. $1 billion to $1.1 billion operating cash flows during fiscal 2022.

And let me summarize and reiterate the quarterly factors that we anticipate for our upcoming fiscal Q1. Q1 is seasonally a lighter quarter for all the factors that Mark outlined in his commentary. We should also be mindful that global recession concerns remain. As we look at where FX rates are today as well as the geographical components of our business, we expect FX headwind in Q1 could be as high as $12 million, and we're expecting approximately $25 million FX headwind during fiscal '20.

Q1 operating expenses is expected to be down sequentially by 4% to 6%. Q1 adjusted EBITDA margin is expected to be down by 100 to 150 basis points.

So in summary, we are very pleased with our fiscal 2019 results, and we look forward to fiscal 2020 and our long-term targets. As you may have observed, we have significantly expanded our internal bandwidth to connect with the investor community. With the leadership of Harry Blount, along with Greg Secord and the team, we look forward to engaging with our stakeholders, share the strength of the OpenText business models and the opportunities that lie ahead of us.

On September 6, is our Investor Day in New York; we look forward to seeing you all there.

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

I would now like to open the call for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Stephanie Price, who's with CIBC.

Stephanie Doris Price - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst*

Mark, I was hoping you could talk a little bit more about the macro environment. You've mentioned the headwinds around trade tensions and FX prior quarters and this quarter as well.

Have you seen any changes in customer buying patterns, given the uncertainty? And can you talk a little bit about the impact on the pipeline?

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

Yes. I mean there's no doubt that tariffs are top of mind, right? Just look at today's headlines out of the U.S., of another 10%. And that does bleed into kind of the corporate psyche and affecting, do I want to spend money for growth or do I want to do more cost-out strategy?

So I do think the market is a bit more cautious today than it was 90 days ago. With that said, we are a very durable business. We don't see a slowdown in our pipeline. But we certainly are seeing kind of the tones of caution out there. And this is why we transitioned our business to a recurring business; 75% of our business in recurring revenues. We had incredible margin and cash flow expansion in the year. And whether we have 1% or 2% variance up on the top line, we're able to grow margins, able to grow cash flows.

So as I look into Q1, we're going to grow year-over-year. I look into fiscal '20, we're going to grow year-over-year. I do think the environment is a bit more cautious.

Stephanie Doris Price - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst*

Okay. And when you think about that more volatile, potentially, environment, can you talk a little bit about the acquisition environment? Are you seeing that impacting the pipeline at all? Are valuations coming down? Has the acquisition environment changed at all?

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

Yes. M&A will continue to be our leading growth driver, as I said in my prepared remarks. Our pipeline is growing, and we expect to get deals done here in fiscal '20.

So valuations in the public markets do remain a bit high. We are seeing some private equity funds at kind of the end of their life and assets getting ready to turn. But let me confirm that M&A is going to remain our leading growth driver. Our M&A pipeline is up and we expect to get deals done this fiscal year at our value playbook.

Stephanie Doris Price - *CIBC Capital Markets, Research Division - Director of Institutional Equity Research & Software and Business Services Research Analyst*

Great. And just one more. Maybe this one's for Madhu. In terms of R&D, so when you look at your target fiscal '20 model, percentage revenue in terms of R&D hasn't changed at all. And when you think about the cost associated with moving to cloud and the quarterly product releases in the cloud, can you talk a little bit about how we should see R&D going forward?

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

Yes, sure thing. Thanks, Stephanie. So when you look at the dollar spend of R&D, right, we continue to look at how much of the spend is in the innovation bucket and it's in the maintenance bucket. And keep in mind, we've expanded R&D in workforce across the globe. And we not only have U.S.-based presence, we have centers of excellence around. So I would say we're able to use our R&D dollars much more effectively.

And you specifically talked about cloud investments. And that's also why where we've maintained our gross margin in the cloud at 57 to 59, where some of the cloud investments is going into that line. And the dollar of spend may be flat or relatively flat. But I can tell you, the people growth is high and the productivity we get from the people growth is also very high to support both innovation and maintenance. Mark, do you want to . . .

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

Thanks, Stephanie.

Operator

(Operator Instructions) The next comes from Richard Tse, who's with National Bank Financial.

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

Just wondering, not withstanding your comments on organic growth, it has been soft for some time, I'm kind of curious to see, are there any hurdles from an OpenText perspective that you would need to clear to sort of accelerate that pace of growth here?

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

Richard, thanks for the question. Fiscal '18, again in constant currency, we grew 2.5%. Fiscal '19, all-in, we're positive, but under 1%, ARR was 1.5% growth in '19. And we're targeting low single-digit organic growth, right, and M&A faster than that. And we're targeting cloud high single digits.

So we're not far from the goal on kind of the next weigh station for us on organic growth. If not for the external factors in Q4, right, which were out of our control of FX, tariffs that affected -- a temporary pause in Asia, and let's not confuse that with the long-term strategicness of Asia, it also paused some public sector spending - you can see that in some of our tables - our organic growth would have been higher.

So in fiscal '18, we're right where we wanted to be at, 2.5%. This year, positive, but a little lower due to the factors in Q4, and ARR at 1.5%. So we're not far from where we want to be in low single-digit organic growth.

I like our total CAGR, though, 12% over the last 5 years. And ultimately, it is about those EBITDA dollars. We generated $1.1 billion and 24% year-over-year expansion of cash flows. We're almost there in low single-digit on organic growth.

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

That's fair. With respect to your comment on professional services, sort of moving away from the lower margin business and using your partners a bit more, how should we think about that going forward? Is it sort of like coming into the zone where we're at this base line? Or just kind of the perspective, I guess for modeling this company.

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

Yes. Again, I like the approach of constant year-over-year. So I'd model constant in '20 over '19. Look at our Q4 margins in PS, 21.6%. And we closed the year at 20. So we run a world-class PS organization. We set out to go after the higher margin business and we captured it. I'll put our business next to the best run PS organizations. We generate better margin than the world's largest firms. And we're modeling constant year-over-year. And that's a good place to be. That gives our partners a lot of room, like Google and SAP and the global SIs to do what they need to do. We're able to capture the high value work to us. So continue to model constant year-over-year. And it's right where we want to be, and the margin is ideal at 20.

Operator

The next question comes from Thanos Moschopoulos, who's with BMO Capital Markets.

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

Question for Madhu. In terms of your organic growth calculation for fiscal '20, did that include an adjustment for the $46 million ASC 606 impact year-over-year, or no?

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

So you mean organic growth for fiscal '19, right?

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

Sorry. For '19 over '18, yes.

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

Yes. We calculated organic growth consistently as we've done before. And I would say when you look at term licenses, specifically 605 to 606, term licenses are part of our growth. So these are, again, new incremental businesses the team has gone out and secured from customers.

So to answer your question, we calculated organic growth consistently as we've done in the past.

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

Okay. But to be clear, you're using an ASC 606 number over an ASC 605 denominator - just to make sure I understand - is that correct?

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

Yes. And that's what we will do going forward as well.

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

Okay. Fair enough. Different question. Mark, when you sell a cloud deal, can you speak to the type of attach rate you're seeing for the OpenText Cloud as opposed to customers hosting with a public cloud provider? And has there been any discernible trend in that metric? Or do you expect it to change on the back of the Google partnership?

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

Yes. Look, I think we had double-digit cloud growth in the year, as we talked about. And as I look into '20, I talked about high single-digit cloud growth for fiscal '20. And our partners are going to help contribute to that. Google's going to help contribute. SAP is going to help contribute to that.

We're not seeing kind of a -- we don't produce a metric that says X% is in which cloud provider, if you will. It's an interesting question. Let me think about that. But I do think -- and I haven't seen a meaningful movement in the percent, if you will. Let me think about that as a metric. But there's no doubt that the Google, the deeper Google relationship is going to grow the business. Now being the SAP defacto partner in the SAP cloud for content services going forward, will contribute to growth as well.

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

And I guess the implication is, over time, that should maybe help cloud margins if the infrastructure burden is being shouldered by somebody else, correct?

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

If I have no cost, it should help margin. If I no to lower cost, it should help margin, yes.

Operator

The next question comes from Walter Pritchard, who's with Citigroup.

Walter H Pritchard - *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

Question for Mark around the 3-year kind of assumptions that you have embedded in the 3-year plan. I'm wondering multi-tenant SaaS, just how you're thinking about adoption there both in the market generally as well as moves you make to come out with products and so forth as cloud adoption continues in your product base.

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

Yes. Walter, thanks for that. Look, I think we're being fairly conservative in factoring in what I'll call our core applications and our OT2 services, aka, public multi-tenant SaaS. The second half of this year is a big product cycle for us, what we call 20.2, you know 20 being the calendar year .2 being the quarter, where we're going to enter the market providing at scale enterprise consumable services for core EIM capabilities. We already have customers in production. 20.2 will allow customers to do this on their own. We're also making incredible progress with our core collab. We introduced electronic signatures.

So we have it factored into our statements of high single-digit cloud growth, our margin expansion target. So a multi-tenant SaaS is factored into that. But I can also say we're being a little conservative on how it's contributing in the model.

Walter H Pritchard - *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

And then obviously, Madhu, I guess, the Asia dynamics seem like they're a little bit out of your control. I was a little bit surprised for you to call them temporary. It does feel like things may be just worsening as you look at maybe 3 months over 3 months or 6 months over 6 months, especially, Mark, you highlighted just new trade tariffs this morning.

What makes you think those are temporary? Or how are you thinking about temporary? Is that just being a 2020 dynamic? I'm just curious what you're factoring into the forecast, really.

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

Yes. So they were my words. So, Madhu, I'll take the question. I'm being optimistic they're temporary. I mean, ultimately, we need to, in my opinion, we have to come -- the governments have to come to a resolution. And when I say temporary, I mean a couple quarters. Could they be longer than that? Sure. But I'm going to be optimistic that it's temporary.

Again, let's not be confused about the importance of Asia in the global economy. So by temporary, yes, they're factored into our views for '20 already. And by temporary, I mean 1 to 2 more quarters.

Operator

The next question comes from Howard Leung, who's with Veritas Investment Research.

Howard Leung - *Veritas Investment Research Corporation - Investment Analyst*

I just want to kind of turn to the discussion on organic growth. Mark, you had mentioned that Asia Pacific was a little weaker. Did you guys look into what the constant currency organic growth rate is just for that region, maybe?

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

No, we don't break it down by -- that's a pretty granular metric. And no, we don't get down to sub-geographies. You're asking for a revenue line in a sublocation. But no, we don't get down to that level of publication.

Howard Leung - *Veritas Investment Research Corporation - Investment Analyst*

Okay. That's fair. And then just one on the 606 impact. Madhu mentioned in Q4 it was less material than in prior quarters. Is that just as result of less term license sales in Q4? And if so, what kind of factors drove less licenses? Just a slowdown in the demand that you were talking about earlier?

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

Yes. Thank you for that. So it was de minimis . . .

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

Madhu, if you want to take 606, I'll take the license question.

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

Sure thing, yes. So in the fourth quarter, it was de minimis. And the license business also kind of grows throughout the year, and I'll let Mark expand on it.

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

Yes. So 606 was 3. --

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

$3.7 million

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

-- $3.7 million.

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

Yes, in the quarter.

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

So quite de minimis over the total revenues.

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

Yes, that's right.

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

Look, license was down. And this is why we pick two metrics, which is recurring revenue and cash flow for the company. And ARR was up in constant currency 1.5% for the year, and we had record operating cash flows, up 24% year-over-year.

I'd also note that third quarter license was strong, and there can be variances per quarter. But license was down in Q4, and it's basically FX and Asia as we talked about, which we think is temporary. And I don't want the world to confuse that with the importance of Asia and our continued investment and importance in our business model.

Howard Leung - *Veritas Investment Research Corporation - Investment Analyst*

Right. No, that makes sense. So I guess you would attribute a lot of that to just really regional factors, and that's why license sales were slower in Q4?

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

External elements, absolutely.

Operator

The next question comes from Paul Steep with Scotiabank.

Paul Steep - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Mark, can you talk a little bit about go-to-market resources? You talked about a boost there. Maybe talk about the timing of when you'd see that contributing, and then the size or the magnitude of the adds that you're sort of looking to do. And then one quick follow-up.

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

Yes. Paul, thanks for the question. Couple important points in there. One is, we're raising the EBITDA target this year. Last year we were at 36% to 38%; this year, we're 38% to 39%. So the bottom ends up 200 bps and the top end is up 100 bps. And we closed fiscal '19 just over 38% in adjusted EBITDA. This is upper quartile performance of all software companies.

And I just want to make the point that 38% to 40% is the ideal zone for OpenText. Some of the world's largest software companies don't operate in this zone. And we chose to be a productivity leader, and we got here faster than others. And I'm very happy to be in this range. Some ranges you're happy with. I'm happy with 38% to 40%. ROIC, I'm happy at 18.7%, right?

Above our range in EBITDA, we will use any excess above that to invest in growth and to invest in value creation. So I just want to be very clear that I'm very happy with the range we're in, and we raised the target range coming into '20.

The investment, if not an investment, would otherwise increase the EBITDA range. We're looking at kind of expansion into our core markets, North America, U.S., Canada, Western Europe. And we have a stronger geographic focus in Latin America, South Africa, Middle East, APAC, and Japan. I'm not going to get to a specific quantum on the capacity expansion, but we are expanding capacity coming into '20. We're also taking our inside sales and going global with it.

But I would really note three things, Paul. One is stronger geographic coverage, it's going to create more intimacy in Korea, more intimacy in Japan, more intimacy in New Zealand, if you will. Second is taking inside sales global. And then third is capacity expansion. That will allow us to get deeper into the Global 10,000 and have more account coverage. More account coverage means more RP coverage.

Paul Steep - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Great. The quick follow-up for Madhu. On ASC 605 to 606, fiscal '19, we saw benefit there. In thinking about fiscal '20, should we consider a reversal there, or simply think that it was a 1x benefit to F 2019 that won't materially impact F '20? Thanks.

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

Thank you again for the question. I would say it was a 1x accounting requirement for 12 months. And again, I emphasize that these are new businesses that the sales team won with the customers. We are required to show the differences, and we did. So going forward in '20, we're going to be showing under one accounting rule 606, if that makes sense.

Operator

The next question comes from Paul Treiber, who's with RBC Capital Markets.

Paul Treiber - *RBC Capital Markets, LLC, Research Division - Associate*

Just wanted to follow up on the term licenses. And I don't want to think so much about the accounting, but more just on the business and nature of the products or the deployments that you're selling. I recognize that it's term license. Can you clarify what leads to term license revenue?

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

Sure thing and Mark can expand as well. So think about the purchase by any customer in terms of a period of time. It could be a 2-year, a 3-year or a 5-year term license, right? And again, the commitment, the advantage here, the benefit here, is they're committing for a longer period of time, which is exactly what we want from a business standpoint. And that includes, obviously, the licenses. It could include the services. It could include the support as well.

So it's really sort of extending the period of time, not just in terms of purchase, but in terms of the commitment to the customer to us.

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

And, Paul, let me emphasize, the term business has always been very small for us, right? Historically, this has not been a large business. It wasn't a large business in -- or a large vehicle for us in fiscal '19. We are more focused on cloud subscriptions, as you can see in our cloud growth numbers.

Some customers choose to do a term license. If they'd like to purchase that way, we will enable it. At the end of that term, they may not even own the IP at the end of the term. I actually think term licenses are not the best long-term value for a customer and how to procure something. And as you saw in Q4, it was de minimis. It was $3.7 million, $3.8 million.

So we much prefer, and the vast majority of what we do, are cloud subscriptions.

Paul Treiber - *RBC Capital Markets, LLC, Research Division - Associate*

And to further clarify, in regards to that, deals with hyperscalers, can you recognize that revenue on a term license basis or on a ratable basis?

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

From a cloud subscription as it says, that would be on a ratable basis. When a term license is purchased, as we described earlier, that will be on an upfront basis.

Paul Treiber - *RBC Capital Markets, LLC, Research Division - Associate*

So regardless of if it's a hyperscaler or deployed at the customer or your facility, is to be recognized in that manner?

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

Yes. It's the nature of the deal itself, yes. Yes, that's right.

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

Yes. So Paul, let's make two distinctions. There's our technology and then where you want to run it, okay? And then what services you may want to wrap around it, right? So a customer can buy a license and choose to run it anywhere. They could procure that license as a term. Very small part of our business. I know it's had focus here in fiscal '19, de minimis in Q4. It won't have the visibility going forward. But you could run that anywhere as well.

What we do in our managed service is come along and provide a subscription around the whole thing, run it in the cloud, we'll provide upgrade services or the application performance management. We provide all the ITIL services, and provide you back just one dial tone and one service for that software. So you can buy the license, run anywhere, including hyperscalers. You could buy a term, run it anywhere you like. Or we could wrap all our services around it, and it becomes a managed service.

Operator

This concludes the question-and-answer session. I would not like to hand the call back over to Mr. Barrenechea for any closing remarks.

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

All right. I'd like to thank everyone for joining us today, and we very much look forward to seeing you at our Investor Day in New York City on September 6. That concludes today's call.

Operator

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