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EDITED TRANSCRIPT

OTEX.TO - Q3 2020 Open Text Corp Earnings Call

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OVERVIEW:

Co. reported 3Q20 total revenues of $814.7m, GAAP net income of $26m and GAAP diluted EPS of $0.10. Expects FY20 total revenue growth in mid-to-high single digits and 4Q20 total revenues to be flat to slightly down vs. 3Q20.

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PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation Third 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 Edward Blount - *Open Text Corporation - Senior VP & Global Head of IR*

Thank you, operator, 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 April 2020; and the second, titled Q3 FY '20 Financial and Business Results, includes information and financials specific to our quarterly results, notably our updated quarterly factors on Page 10.

In May and June, OpenText management is pleased to virtually meet with investors at the following conferences. CIBC's Technology and Innovation Conference on May 13, Barclays Americas Select Franchise Conference on May 14, Needham's Technology and Media Conference on May 19, Bernstein's Strategic Decisions Conference on May 29 and Bank of America's Merrill Lynch Global Technology Conference on June 4. 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 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 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, including in relation to the current global pandemic 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 be found on our website. We undertake no obligation

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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 very pleased to hand the call over to Mark.

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

Thank you, Harry. Good afternoon, everyone, and thank you for joining today's call. On behalf of the OpenText community, we honor the brave women and men who are serving on the front lines of this pandemic: our health care professionals, first responders, infrastructure and cloud experts, food processors and other essential workers who are keeping us healthy, safe and productive. Our hearts remain heavy with the loss of life and hardship. And during these difficult times, our spirits are uplifted with hopes, acts of kindness and courage. The health and well-being of our employees is our first priority as well as our customers and partners.

I'm pleased to highlight that the OpenText community is doing exceptionally well. This pandemic impacts every aspect of our work and lives. As we say in Canada altogether or tous ensemble. I'm inspired every day by the resiliency and innovation of my colleagues. I am so proud of the OpenText leadership, our employees, their dedication to customer experience, operational excellence and their resiliency during this pandemic. While there remains and is still a long journey ahead for all of humanity, we look forward to our in-person comradery returning soon.

OpenText is a unique platform, a very strong company, and we are well positioned for the seminal moment in time. We will come out of this stronger than we went into it.

Let me spend a few moments on our Q3 financial highlights. We delivered record total revenues of $815 million, up 13% year-over-year or $820 million in constant currency. This is our 21st consecutive quarter of total year-over-year growth in constant currency. We had record annual recurring revenues of $662 million, up 21% year-over-year. Our annual recurring revenue, ARR, was a record 81% of total revenues.

Cloud revenues of $340 million, up 42% with a 590 bps margin increase to 63%. Record customer support revenues of $323 million, up 4% with a margin of 90%. Our renewal rates remain strong in upper quartile, both cloud and off cloud. Americas was 63% of our business; EMEA, 29%; and APJ was 8%, with a stronger shift to the United States. We generated $260 million of adjusted EBITDA dollars or 31.8%, record operating cash flows of $330 million and trailing 12-month operating cash flows of $904 million. We ended the quarter with $1.4 billion in cash with a net leverage ratio of 2.25x. We expect our net leverage ratio to decline in the coming quarters. We advanced our business during Q3, and let me highlight a few key areas and more details to follow in my script.

Notable customer wins in critical infrastructure industries included Nestlé, United Health Services, General Motors, Continental, Daihatsu, Diamond Pharmacy Services and Pathos lab testing. We announced new partnerships with Amazon and Dun & Bradstreet. We acquired XMedius, a data and voice solutions provider with an installed base of over 50,000 that expands our ARR in on-demand messaging. We formed a new OpenText U.S. Public Sector Group, bringing together all our U.S. public sector activities within one group: civilian, defense, intelligence, state, local and national laboratories. We published 2 Webroot reports on cyber threats and consumer security behaviors. We announced a suite of cutting-edge new cloud capabilities at Enterprise World Europe Digital with Cloud Editions 20.2. Our new citizen developer site-based on OT2 is live at developer.opentext.com, the ability to rapidly build new content workflow forms based applications is essential for digitalization. And we completed a successful refinancing in early Q3 that extended our debt maturities into 2024 and lowered our coupon.

We seamlessly transitioned to a work-from-home environment and drove a solid Q3. We are engaging with customers and prospects in our scaled up OpenText digital zone. The OpenText digital zone enables events, demos, architectural design sessions, pilots, support, deployments and customer operations. OpenText Enterprise World Europe was conducted in the digital zone last month. And we have had over 10,000 engagements so far. When you bring this all together, here is the main point I want to highlight, as I commented on in previous calls, our business is transformed. In 2011, ARR was approximately 54% of revenue. We had no cloud business. License was 26% of revenue and our adjusted EBITDA margins were in the 20s.

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Last quarter, in Q3, ARR was 81% of revenue. Cloud was our largest segment. License was 10% of revenue, and our adjusted EBITDA was in the 30s. By all measures, we have reshaped our business into a cloud business with high recurring revenues. We'll always honor how a customer wants to purchase subscription or license and how they want to deploy, cloud, off cloud or hybrid.

With that said, we are transformed, and we are well positioned to weather the short-term challenges and for long-term growth. The pandemic is massively accelerating discussions on digitalization, cloud, the edge, but also impacting overall demand, especially in those industries that are already heavily invested in, such as auto, airlines, hospitality, oil, travel and retail. But the pandemic has also strengthened our purpose to help companies transform. I said a few quarters ago, this moment, this movement to the cloud is a once in a 20-year opportunity. This remains so. And it will accelerate even faster now once we get through all the demand challenges, consider the need to digitize is more urgent.

Moving to the cloud is contactless for most customers' businesses, the edge is as important as the cloud. Remote work is here to stay. Working from home is an essential part of the new equilibrium. Home, school, gym, place of retreat or worship, all combined into one physical space, and that space needs data and information and threat protection. We all work and live at the edge of the network. And we are really delighted to be in this business with our Carbonite acquisition. Building knowledge economies and collaboration is essential when you cannot be physically in an office, person to person, and it's harder to build new relationships. Stellar customer experiences overall and especially with contactless retail. Direct-to-consumer accelerates even faster. And finally, the need for digital, agile and rapidly adaptable supply chain platform. We have over 2 million trading partners and 60,000 customers running on our trading grid. Those customers on our grid have a large competitive advantage as they can change their manufacturing output within days. We helped numerous companies transition to PPE in Q3 at record speeds just as an example.

At OpenText, we see these changes in behaviors and long-term structural shifts as opportunities to help our customers automate and transform their businesses with our software and expertise, leveraging our new OT2 services and 20.2 Cloud Editions for content services, business network, digital experience and cyber resiliency.

I'm particularly proud of how OpenText has supported the global response to the pandemic and helping our customers through this seminal event. Health care and patient care with the NIAID, NHS, Cerner, McKesson, CVS and Cardinal Health; biotech and pharmaceuticals, Novartis and Novo Nordisk; governments and defense, NATO, U.S. DoD, Government of Canada; Energy, PG&E, BP, Sempra, Chevron; financial services, the ECB, Bank of England, BofA, Wells, JPMorgan; critical manufacturing, B. Braun, Bosch, GM, Siemens, Philips; food and agriculture, Nestlé, Mars, Cargill; telecommunications, AT&T and Verizon; transportation and logistics, Union Pacific, Knight, FedEx, UPS. We are all together with our customers through the seminal point in time.

Let me transition to the preemptive choices we have made at OpenText to weather the shorter-term uncertainties and the new realities of returning to work. We believe it is better to be decisive and clear, not slow and incremental. Our preemptive choices include continuing to focus on total growth. We're going to continue to make investments for future organic growth, grow our cash position and be in a position to deploy capital for the right opportunities, strengthening our already durable and resilient business model. ARR was 81% in Q3, our highest ARR percent in the history. And with the launch of the Cloud Editions, we expect the shift from license to cloud to continue and to grow ARR being centered on strong operating cash flows, regardless of the macro environment. To that end, we are announcing today a set of cost control measures and a restructuring program. This is a single-decisive action, not the first of multiple rolling actions. The cost control programs are temporary, while the pandemic persists, the restructuring programs are permanent. The temporary programs include, we are reducing our anticipated cash payroll expenses for the last 45 days of fiscal '20 and for fiscal '21, based in variable; the CEOs total by 63%; the Board of Directors' fees by 15%; the executive leadership team by 15%; managers by 10%; and our valued contributors by 5%, with some exceptions in India and Philippines. We have also reduced discretionary spending, narrowed hiring to exceptional difference makers and instituted other cost measures. The permanent restructuring programs include our work from home has been amazingly productive. Given this, we decided not to reopen approximately 50% of our offices and institute a hybrid model with some employees continuing to work from home. These are smaller offices, and we will close them immediately and permanently, and this only affects about 15% of our workforce. Our corporate offices, our centers of excellence, innovation centers and country head offices will remain open, when we are able to do so. Conjunctive with this, we commenced a rebalancing program that will reduce our workforce by up to 5%. We expect the workforce rebalancing and the strategic change in return to workplace to reduce annualized expenses by $65 million to $75 million a year.

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Maintaining a very strong balance sheet is always a priority. We ended the quarter with 1.4 -- $1.45 billion in cash and a 2.25x leverage ratio, and that ratio will decline as we build more cash. We drew $600 million of our revolver preemptively and with our refinancing in July -- in early February, we extended our maturities and lowered our coupon. Our first debt maturity is now 4 years away in 2024.

Let me provide some highlights on Carbonite. Our strategy and industrial logic on Carbonite -- on the Carbonite acquisition was to extend the OpenText influence into cyber resilience, data and information protection and to enable information and work at all end points, while our customers operate at the edge of the network. The edge and the cloud need to work together. With the rapid expansion of work from home and this long-term structural shift, Carbonite products become even more important for the enterprise, SMB and the consumer. Carbonite had a solid first quarter of operations, and we are on our internal business case for the acquisition. Carbonite delivered $110 million of revenues in its first quarter and in its first quarter was immediately accretive to adjusted earnings and cash flows. You'll see in our investor materials that we had expected Carbonite -- we expect Carbonite to exceed our previous second half fiscal '20 range of $190 million to $200 million. Carbonite contributed to our cloud growth. The combined operations improved our cloud margins into the low 60s and the integration on the business -- of the business remains on track. We're also watching closely SMB closures, spending cuts and potential bankruptcies. In Q4, we did not see an impact.

Let me spend a moment on the road ahead. And given the environment, we expect some variability. In the first half of our fiscal year, we had positive organic growth. Year-to-date and including Q3 in constant currency, we had positive organic growth in ARR. With 2 months to go, our full year organic growth will be challenged due to the pandemic and the macro events out of our control.

For the full fiscal year '20, we are expecting total revenue growth in the mid- to high single digits. We're also expecting strong cloud growth in the low 20% range and low single-digit customer support growth. License and PS should each decline year-over-year as we continue our transition to the cloud and customers in highly invested industries navigate the pandemic. We are keeping our fiscal '20 target model in place while updating a few ranges today. ARR increasing to 76% to 78%.

Adjusted EBITDA margin decreasing slightly to 35% to 36% and CapEx reducing to $72 million to $77 million. We are maintaining our dividend program. And today's dividend announcement is consistent with our previous practices at $0.1746 per share. OpenText believes strongly to returning value to its shareholders and intends to maintain this dividend program. For our usual cadence, we'll update you in August on our fiscal 2021 plan, and our 3-year long-term aspirations. As a note, starting in August, we plan to shift our discussion away from OCF and shift that discussion to FCF, moving from operating cash flow to free cash flow starting in August. Again, and I note, our trailing 12-month OCF was $904 million, our strongest TTM in the history of the business.

Our Q4 factors include a highly fluid market due to the pandemic health and economic crisis, disruption in many industries, auto, oil, energy, transportation, airlines, retail disruption in supply chain availabilities. And for Q4, we are modeling and expecting an FX headwind of $14 million, approximately $14 million, revenues flat to slightly down sequentially quarter-over-quarter and adjusted EBITDA dollars flat to slightly up sequentially quarter-over-quarter.

Let me summarize my prepared remarks. We are shaped by our experiences and our mind's view of what we envisage our new equilibrium to be. I lived and work through the dot-com boom and bust, 9/11 and The Great Recession and my near-death experience with acute myeloid leukemia and subsequent bone marrow transplant. Through my cancer treatment, I lost my immune system 3 times and was isolated for over 100 days. While none of these experiences can fully prepare one for a pandemic and a great lockdown, they can inform your approach to actions, communications and transparency. We are being preemptive with our choices at OpenText. We are going to lead as the best information management company in the world. We're going to help customers accelerate their transformation through our platform: digitalization, cloud, the edge, cyber resilience and supply chains. We're going to lean into the new workloads, use cases and structural shifts across the marketplace.

Last summer, I talked about doubling our sales coverage for the Global 10,000 over the next 3 years and investing $2 billion in R&D over the next 5 years, and we remain committed to that level of innovation. This innovation is the underpinnings of future organic growth. Our software is hybrid, and so will be our work, as we intend to lead the way in remote work and the return to the workplace. We'll continue our focus on growing recurring revenues and cash flow and cash. We operate with a strong balance sheet. We'll be ready to deploy capital using our ROIC-driven value-based playbook for the right opportunities, and we'll maintain our commitment to shareholder returns, dividends, transparent communications, and direct and ongoing engagement.

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I'm pleased with our solid Q3 baseline, while we all managed through this seminal moment. The leadership team is committed to work smartly, selflessly and tirelessly through this crisis. We will come out of this pandemic stronger than we went into it, in part because of the preemptive choices we have made. Altogether, tous ensemble . Let me 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. Our Q3 results was solid and reflect our operational excellence and a continued focus on our balance sheet. We are proud of the DNA and culture at OpenText as we continue to optimize the cost structure, initiate and execute preemptive cost measures with a strong balance sheet and a highly efficient operating framework, we are well positioned to address the shorter-term challenges and longer-term growth. And before I share my commentary on Q3, please note that our updated fiscal '20 target model is included in our Q3 investor presentation posted on our IR website and will be addressed in my comments. And similar to prior quarters, my references will be the 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 $814.7 million, up 13.3% or up 14.1% on a constant currency basis. Foreign exchange continues to be meaningful. There was a $6 million FX unfavorable impact to revenue in the quarter. Year-to-date, total revenues were $2.3 billion, up 7.6% or up 8.8% on a constant currency basis.

Earnings per share. Q3 GAAP earnings per share diluted was $0.10, down from $0.27 and primarily due to the incremental impact of amortization relating to the Carbonite acquisition. Q3 non-GAAP earnings per share diluted was $0.61, down from $0.64 or down $0.02 on a constant currency basis. Year-to-date, GAAP earnings per share diluted was $0.77, down from $0.79. Year-to-date, non-GAAP earnings per share diluted was $2.09, up $0.05 or up $0.10 per share on a constant currency basis. The geographical split of total revenues in the quarter was Americas 63%, EMEA 29% and APJ 8%.

Annual recurring revenues were $662.3 million, up 20.6% or up 21.3% on a constant currency basis. Year-to-date, ARR was $1.8 billion, up 11.1% or up 12.2% on a constant currency basis. Annual recurring revenues as a percent of total revenues was 81% for the quarter, up from 76% in the prior year and 78% year-to-date, up from 75% in the prior period.

Our cloud revenues were particularly strong at $339.5 million, up 42.3% or up 42.8% on a constant currency basis. Year-to-date, cloud revenues were $825.1 million, up 23.9% or up 24.7% on a constant currency basis. Our cloud renewal rate remains in the mid-90s. Our customer support revenues was $322.9 million, up 3.9% or up 4.8% on a constant currency basis.

Year-to-date, customer support revenues were $950.7 million, up 1.9% or up 3.3% on a constant currency basis. Our customer support renewal rate remains in the low 90s. Our license revenues were $81.1 million, down 17.9%, or down 17% on a constant currency basis, primarily due to the pandemic impact on our license business during the quarter. Year-to-date, our license revenues were $297 million, down 3.7% or down 2.3% on a constant currency basis. Professional services revenue was $71.3 million, up 0.3% or up 1.5% on a constant currency basis. Year-to-date, professional services revenues were $210.3 million, down 2% or down 0.4% on a constant currency basis.

Turning to margins. GAAP gross margin was 65.4%, down 130 basis points, again, primarily due to the incremental impact of intangible amortization from Carbonite. Year-to-date, GAAP gross margin was 67.5%, up 20 basis points. Adjusted gross margin was 73.3%, up 30 basis points. Year-to-date, adjusted gross margin was 74%, down 10 basis points. During those periods, adjusted gross margin is well within the range of our fiscal '20 target model.

Also on an adjusted basis, cloud margin was 62.5%, a 410 basis point improvement from Q2 fiscal '20 and up from 56.6% last year. Year-to-date, cloud margin was 59.7%, up from 58%. Our customer support margin was 90.1%, up from 89.9%. Year-to-date, customer support margin was 90.5%, up from 90.1%. Our license margin was 96.9%, down from 97.3%. Year-to-date, license margin was 97.3%, up from 96.7%. Professional services margin was 21.2%, up from 20.9%. Year-to-date, professional services margin was 22.2%, up from 21.7%. Adjusted EBITDA was $259.5 million, down 0.9% or up 0.5% on a constant currency basis. Margin-wise, this represents 31.8%, down from 36.4%.

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Year-to-date, adjusted EBITDA was $830.7 million, up 1.8% or up 3.5% on a constant currency basis. Margin-wise, this represents 36.4%, down from 38.5%. As a reminder, both the quarter and year-to-date results include a full quarter of Carbonite financials. Our adjusted net income was $166.3 million, down 3.9% or down 2% on a constant currency basis. Year-to-date, adjusted net income was $566.8 million, up 3% or up 5.4% on a constant currency basis. GAAP net income was $26 million, down 64.3%, primarily due to $48 million of incremental impact of intangible amortization from Carbonite. Year-to-date, GAAP net income was $207.9 million, down 2.7%.

Turning to operating cash flows. They were a record $329.6 million, an increase of 15.2%. Year-to-date, operating cash flow was $674.3 million, up 4.3%. Q3 reflects continued solid performance on our well integrated working capital framework. We had record collections. Q3 DSO was 51 days, an improvement of 9 days compared to Q3 fiscal '19 all notwithstanding the advent of the pandemic during March. Carbonite remains accretive to our working capital. And despite our Q3 strength, we are mindful of and closely watching the short-term challenges ahead.

From a balance sheet perspective, we ended the quarter with approximately $1.45 billion in cash, given strong cash flow performance and $600 million from our revolver drawn as a preemptive measure in the current environment. The proceeds from the revolver are presented within cash and cash equivalents. The refinancing announced in February further strengthened our balance sheet position, extending our earliest maturity to 2024 and the latest out to 2030, our consolidated net leverage ratio remains at 2.3x. And a Carbonite update, Q3, as I said, is our first full quarter with Carbonite results. The integration is going well, and we remain on track to our target operating model by the end of fiscal '21 or sooner. The acquisition remains accretive to annual recurring revenues, cloud margin, adjusted EBITDA and working capital.

On the restructuring plan, today, we announced a restructuring plan that will impact our global workforce and consolidate certain real estate facilities. As a result of the pandemic, more than 95% of our employees are currently working from home, and we're making plans for a hybrid future return to workplace strategy. We currently have approximately 120 offices around the world. And our intent over time is to reduce over 50% of our global offices, impacting approximately 15%, 1-5 of our employees. The estimated cost of the real estate facility restructuring is expected to be in the range of $65 million to $80 million. We have also approved and begun executing a workforce rebalancing program across various departments in order to further reduce our cost base in light of economic uncertainty.

We estimate severance costs to be in the range of $15 million to $20 million. The total cost of the restructuring, including workforce and facilities is expected to be approximately $80 million to $100 million. We expect to incur the restructuring expense during Q4 of this fiscal year. Once completed, we anticipate annualized expense savings of approximately $65 million to $75 million. Q4 savings will be minimal, and we expect a substantial realization of savings during fiscal 2021. We're also taking a number of additional preemptive measures, including reduction in discretionary spend and temporarily reducing the salaries of executives, senior leadership and other employees as well as our Board of Directors.

On the quarterly factors, let me summarize and reiterate the quarterly factors we anticipate for our upcoming Q4. As we look at where FX rates are today as well as the geographical components of our business, we note that the FX headwind fiscal '20 year-to-date was $26 million to revenue. We expect approximately $40 million annual FX headwinds for the full fiscal 2020. Furthermore, expect Q4 total revenues to be flat to slightly down compared to Q3 '20, expect adjusted EBITDA dollars to be flat to slightly up compared to Q3 -- compared to Q3 '20.

On the target operating model, let me highlight the following changes. Annual recurring revenue is being increased 100 basis points to a range of 76% to 78%. Although we're not changing our target range for license revenue, we do expect a decline in fiscal '20 compared to fiscal '19. Our adjusted EBITDA margin is lower by 100 basis points to a range of 35% to 36% and primarily reflecting the anticipated impact of the pandemic during our fourth quarter.

Capital expenditures to a range of $72 million to $77 million. We continue to see efficiencies in our capital spend. All other elements of our fiscal '20 target model remains unchanged. Our long-term aspirations, as Mark mentioned, we will update you in our fiscal 2021 plan and our long-term aspiration during the fiscal year-end call in early August for our usual cadence, including adjusted EBITDA. And a shift to free cash flow from operating cash flow. On the tax update, the IRS matter is still in the appeals phase, and our resolve remains strong as we continue to vigorously defend our position.

Dividends. And finally, turning to our dividend program. Today, we announced a quarterly dividend of $0.1746 per share payable on June 19, 2020. Our rate remains the same based on a target of distributing approximately 20% of our trailing 12 months operating cash flow.

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In summary, we are pleased with our Q3 results with strong cash flows, solid balance sheet and initiating a number of preemptive measures in light of the current global pandemic. All of which will enable us to remain highly focused on delivering against our total growth strategy. The strength of our people, processes and systems were on full display in the current environment this quarter and demonstrated the durability and resilience in our organization. We remain confident in continuing to benefit from this model as we look ahead.

I would like to extend a special thank you to the teams at OpenText for a successful pivot and incredible efforts during the quarter. A thank you to our shareholders, whose trust and confidence we greatly value. And finally, I'd like to wish every one of you an abundance of health and safety.

I would now 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*

Congrats on a great Q3. And I hope you all stay healthy, and our thoughts are with you guys as well. The -- quick question for you, Mark. You've seen kind of downturns before as well. Like if you think about the current situation, what's the -- can you talk a little bit about what you're kind of looking out for in terms of either like conversion rates versus pipeline building versus churn, especially now that you own Carbonite with more SMB focus. Just kind of help us a little bit to understand like how you're trying to or will manage through the current situation? And then I have a follow-up.

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

Yes. Very good, Raimo. Thanks for the question. We are well and wish you and your extended family the same name. Look, I think at the end of the day, the guiding principle is going to be by industry, right? The -- every industry is going to be different. Auto is going to be different than retail, which is going to be different than health care and hospitals. So we're taking an approach to understand our business and the patterns and any structural shifts industry by industry. So that's sort of kind of an Uber approach that we're taking. There's no doubt that, in general, there's an acceleration in transformative discussions. We highlighted the ones that we're seeing: digital, cloud, remote work, cyber, supply chains. When we add up our revenues into those industries, we think that are most challenged here in the short term, it's upward to about 20% of our revenues. Now that's balanced by expansion discussions that we are having in health care, pharma, industrial manufacturing and government. So it's -- when you kind of translate all those short-term effects together, for our F '20, we're expecting to grow mid- to high single digits. But before COVID, we expected a slightly higher growth rate. So we're taking a look at it by industry, industry by industry. You have places where across the board, there's accelerated discussions. But there are more challenges in certain industries and accelerants in others. As it relates to SMB, we're clearly monitoring it. The Carbonite business isn't all SMB. There's a good portion that's enterprise. There's a good portion that is OEM, which is enterprise. Our consumer direct business was actually on an uptick in Q3. And of course, there's the SMB portion of the business. We saw no effects in Q3. But we're clearly monitoring it very, very closely. So let me pause there, and I think you said you might have a follow-on or second part of your question.

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

Yes. Then, because it's -- we're in kind of -- we are in familiar, but we're also in unchartered territory a little bit in this kind of situation. Can you talk a little bit about, what are the signals or the metrics that you guys going to focus on most in terms of kind of managing it and kind of making decision in terms of like changing behavior or changing something? I mean you took very kind of decisive action already now, but like what's the guiding principle for you here now as you go through the crisis?

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

Yes. So we're clearly being preemptive on our choices, as you noted and we noted it in our script, we think it's better to be decisive versus slow and incremental. Look, I learned that through my cancer treatment. I learned that through The Great Recession, right? And you just got to prepare to weather the challenges. Look, we're going to follow like most -- out in the market, what I call the 3 Ts, right? We're going to track testing, we're going to track tracing and we're going to track treatments as a general market. And we're going to track industry by industry. We're going to look -- we get good insight to our business network on many industry trends. And Raimo, the best I think I can highlight right now, yes, you have the usual pipeline in other metrics, but we're going to take a very industry-by-industry view. In each industry, without going through every industry here, we're going to track and trace, if you will, the detailed industry metrics because this recovery is going to happen in industry at a time.

Operator

Our next question comes from Paul Steep of Scotia Capital.

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

Could you talk maybe just a little -- the cloud growth in the quarter, maybe measures you're taking, whether you've done anything to actually accelerate the transition towards the cloud and sort of push even harder towards that direction beyond the acquisitions that we talked about earlier?

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

Well, it's kind of pre-COVID. We didn't make structural changes coming into the fiscal year. We certainly put leadership and management priority on it. But Paul, the pandemic is an accelerant to the transition to cloud. Customers who are not able to -- I mean we're very blessed and fortunate to have invested for many years and a very strong technology platform, our own information management technologies. And we think about how we operate a 15,000-person company today working from home. Look, we processed trillions of commerce through our trading grid over the last 100 days. And the conversation to accelerate to the cloud to accelerate -- the conversations of cloud and digital are simply being accelerated due to the pandemic. And we're going to be here altogether to help our customers make that transition rapidly. Whether it be consolidated content services to build knowledge economies, whether it be leveraging our trading grid to rapidly adapt supply chains. We had numerous customers who we helped in Q3 that were going from traditional industry manufacturing who had to onboard 2,000 new suppliers, thousands and thousands of new parts to build a platform to be able to move to PPE manufacturing, and we were able to do that in record time. So they could go reconfigure the physical manufacturing space. So the pandemic is accelerating these conversations. We haven't had to change structurally our comp plans or anything like that to do this.

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

Great. And then just a quick follow-up on it. Maybe put context for people on the call around what Muhi and the team has done with today's announcement, now that you've added the other major cloud service provider on the public side and how clients or whether clients have sort of pulled you towards Azure and AWS?

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

Yes. Yes, sure thing. So we announced a relationship, an expanded relationship with AWS today. And we've previously announced our relationship with SAP, Google. We've always partnered with Microsoft as well. Now 20.2, our Cloud Editions are cloud first. They are native cloud applications. They're completely containerized. And we really have kind of completed the tech stack and now the business relationship side to give full choice to our customers. So if a customer has sort of standardized on AWS, if they standardize on Google, they've standardized on Azure. We can seamlessly

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support their business decisions and their operating decisions as well as our tech stack. So 20.2 important steps, native cloud, cloud first, AWS really is one of the last big pieces for us to firmly support, as I like to say, completing the need and the choice for our customers.

Operator

Our next question comes from Stephanie Price of CIBC.

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

Congrats on the quarter.

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

Yes. Thanks, Steph. Good to hear your voice.

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

You too. Thanks for the color on what you've seen so far. I was just wondering if you could talk a little bit about what you've seen in the first couple of weeks of April. And maybe a related question, as regions start to open up, are prospective customers picking up where they left off? Or how quick are they to reengage?

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

Yes. It's -- software is still unusual where you sort of get the end of quarter activity. And look, I couldn't be more pleased that we've completed the transition from license business really into a cloud business and a highly recurring revenue business. If I look at -- we have the transactional work we do and then we have the network work that we do. And on the network side, it seems to be sort of stable coming into April, I would say. You had the end of last year -- end of last calendar year. You had January a bit down. You had February a little lower down. February -- excuse me, March a little lower down. And in April seems to be sort of a bit more of a steady state right now. It's too early to declare anything. But I'd say here in the first month of the quarter, it seems to have kind of been steady to where we -- from end of March. If we just go around the world, China has certainly begun -- begin to return to workplace. Southern Europe has begun to return to workplace. I think it's still too early for Western Europe and North America yet. And there are still places that are not plateaued, whether it be India or South America. But from what we can see in our business, we have the transactional piece, we have the network piece. The network piece is sort of stable to where it was at the end of March. But I'm just going to note, it's still just too early to make any predictions.

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

Okay. And then maybe for Madhu, just on the cloud margins this quarter, obviously, very, very strong. Just wondering if you could elaborate a bit on the strength. Is it all related to the Carbonite integration? Should we kind of see this as the new run rate going forward?

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

Yes. It's great -- I mean it's a great question. I would say, think about it in 3 parts, right? Once certainly, we continue to optimize from an OpenText cloud perspective, our cost framework. And we certainly see the benefit of that. And Carbonite is a full quarter and predominant of Carbonite

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revenues are, in fact, I mean, in the cloud. And I also spoke about the CapEx efficiency we're seeing. So I would say all 3 factors definitely contributed. And we've talked previously about being in the low to mid-60s, right, and you should definitely look to us to be in the low 60s as we look ahead as well.

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*

With the global move to work from home across a number of organizations, it seems structural and permanent. As you're experiencing it firsthand, what do you think is perhaps least understood about the challenge in transitioning, including IT and moving to work from home? And then as you think strategically, how do you think that -- or how will that help you further reshape OpenText's software portfolio to address that going forward?

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

Yes. Yes. Thanks for the question. I think many of us, many of us tech companies are very tech-oriented businesses. If I walked into my management team meeting last year Monday morning, and sat my team down and said, look, we're going to go send everyone home for the next 2 months. And let just see how it goes. I would -- I probably would have got laughed out of the room. Yet we've all now experimented at scale -- many of us have experimented at scale of having our workforces telework, and I think many of us have been surprised just how effective it is. And in some cases, productivity is up, and it works. So for us, we see it as an opportunity to think differently about what the new return to workplace looks like. We're not going to be constrained in certain markets. This will open up some talent pools for us to think more widely about the talent we can bring on board. And I also think it will reinvent content services, right? Content services at its heart is a knowledge platform. You think about how you do a remote close, how you do many major processes when you have a remote workforce, if you don't have knowledge bases or knowledge economies, as I call them, it's very hard to work. So I think on one hand, many of us have been surprised just how productive it has been. None of us would have experiment like this on our own. I think you're going to see some permanent changes in that hybrid work. I think it's going to, in a lot of ways, reinvent, reinvigorate content services and these are some of the things that we're seeing.

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

Just another question for me. In regards to Carbonite, the quarter was significantly above our expectations. And then on a run rate basis, above your prior outlook. Does the upside in the quarter, does that specifically relate to work-from-home demand that you did see? Or was there another driver that drove the upside there?

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

I would say a few things. One is good integration and execution as well as -- there's going to be those places that are somewhat, as we talked about, challenged, auto, airlines, travel, hospitality, oil. But as the workforce moved home, and home is more than just home, it's home, office, school, gym and many people at home. We did see high renewal rates and strong interest in our kind of direct business to consumer and prosumer. So I'd say it was a bit of the integration and execution as well as an uptick in an opportunity due to the work from home.

Operator

(Operator Instructions) Our next question comes from Richard Tse of National Bank Financial.

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

Yes. So I understand there's certainly a potential for acceleration broadly on the other side, particularly in cloud. But has this current crisis kind of uncovered any specific product areas that you can actually see outsized pickup in interest here that you weren't really seeing before?

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

Richard, thanks for the question. Look, I think the areas of focus and more conversation are around consolidation of content services, our core collaboration suite and e-signature, lots of conversations and the protection of the home and end points. These are things that are certainly in the green column for us more so than they were pre-COVID.

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

Okay. And then you mentioned a bunch of different verticals like auto, airline, hospitality, obviously, those are very, very challenged verticals. But yet when you sort of look at the kind of the remainder of the year, you still seem pretty optimistic. So obviously, that's pretty impressive. So if you were to say, it was in a normalized state, organic growth. Can you maybe talk about what that would have been under kind of normal conditions?

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

Well, as I said earlier, we're not going to talk about fiscal '21 yet, right? We'll stay on our usual cadence. When we get to August, we'll talk about fiscal '21, as we usually do. For here and -- I'm just going to talk at the fiscal year level, Richard. So for fiscal '20, we're expecting to see another growth year. So total growth in the mid- to high single digits, cloud growth in the low 20s. In relation to organic growth, which I think is your question, the first half of '20, we had organic growth. Year-to-date, in constant currency, we had organic growth in ARR. But 2 months ago, organic growth will be challenged, right, due to COVID. And whereas we have some -- there are heavily invested industries that have pressure, as we all know. We have expansion discussions in other industries, health care, pharma, industrial manufacturing. This does translate into short-term effects for us. As I said in my prepared remarks, right? Our F '20 growth is expected. All in, our F '20 growth is expected to be in the mid- to high single digits. And before COVID, we expected higher growth. So we're still going to have a growth year. We're still expecting a growth year, but we clearly have growth impacts because of COVID.

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

Okay. And just one quick one for me, the last question. In terms of the acquisitions, maybe talk about the ability to pursue acquisitions here in the next few quarters? And do you see a change here over those next few quarters in terms of valuations in the marketplace?

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

Yes. Thanks, Richard. So it's -- we remain -- we remain in the market pursuing opportunities. So there's no doubt that the pandemic is going to affect valuations downwards. For the markets that we seek assets in. We continue to build a strong balance sheet, 2.25x leverage and declining. But we're going to continue to pursue opportunity. The right opportunity at the right time. Clearly, any buyer has to understand the effects of the pandemic on that business. It requires yet another part of a playbook to do the due diligence. So we're going to seek -- it's the time to seek -- to seek companies in your core markets that you already know and that are just strong brands with high recurring revenues. I don't think it's a time to kind of get out of your wheelhouse. So with that, we're continuing to pursue opportunity. Speak with companies, build our pipeline, continue to do deep discussions and for the right opportunity and the right asset we'll be prepared.

Operator

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

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

Mark, can you speak to what you're seeing in your transaction-driven businesses like the trading grid, given everything going on, are transaction volumes generally up a lot, down a lot? If they are down, to what extent you have contractual minimums that might preserve some of the revenue?

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

Yes. Thanks, Thanos. Look, I'm not going to translate traffic. Traffic doesn't necessarily translate directly into revenue, right? We have overages. We have underages, some contracts are yearly averages. So it's not a direct relationship. There are places where we've seen increased traffic. If we look at pharmacy, health care, actually, certain industrial manufacturers as well. We've also seen areas that have much lower traffic, of course, retail, CPG, auto. You add the pluses and the minuses, the traffic is down overall, but doesn't translate directly into kind of a -- kilo character down doesn't translate that to $1 down, if you will. So we factored that all into how we look at the year. Again, for fiscal '20, we're expecting mid- to high single-digit growth all in. But overall, to answer your question, the traffic is down. We have places that are positive. Many places that are negative. But yes, the positives and negatives, it still equals a negative. And we think it's a short-term issue, and we'll wait to see the other side.

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

Great. And in the current climate, are you seeing any pressure on DSOs, the customers asking for longer payment terms? Or for that matter, are existing customers pushing you for concessions on maintenance renewal pricing, or not to date?

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

Yes. I think it's safe to say, every industry is going to talk about longer payment terms, that every industry is going to talk about renewal rates. We experienced in Q3 very strong renewal rates. And look, we're in a great position because we offer a suite of products. We're able to offset those conversations with more product, more services, consolidation opportunity. And look, the maintenance and features and the service is what's running a lot of these essential industries. So I think we're in a great position to be able to maintain upper quartile renewal rates, both cloud and off cloud. Given we take a platform, product portfolio approach, consolidation approach, we are the platform that is essential in many businesses. So I feel really good on our renewables. Every company is -- everyone is asking for longer payment terms. We're going to do what's right and fair here in the short term. And as everyone should as we say all together, we'll do what's right and fair for those industries and customers who need our help. And our preemptive actions also help offset anything. And you saw that kind of altogether spirit actually create record cash flows in Q3.

Operator

This concludes the question-and-answer session. I will now hand the call back over to Mr. Barrenechea for closing remarks.

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

Okay. Well, thank you, everyone. This was certainly a very unique time and a seminal moment to have an earnings call. Our solid Q3 puts us in a great position to weather the short-term challenges ahead. We had 21 consecutive quarters of year-over-year growth in constant currency, record revenues, record ARR at 81%; record cloud $340 million, up 42%. We're maintaining our dividend and visibility. And our hearts and minds are with all those affected by this series of events and pandemic.

Thank you for joining today's call, and we'll see you on our conferences in the quarter. Thank you very much.

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Operator

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

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