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OTEX.TO - Q2 2021 Open Text Corp Earnings Call

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PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation's Second Quarter Fiscal 2021 Earnings Conference Call. (Operator Instructions) The conference is being recorded. (Operator Instructions) I would 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 our consolidated investor presentation that will supplement our prepared remarks today. The presentation includes information and financials specific to our quarterly results, notably our updated quarterly factors on Page 7 as well as a strategic overview.

And now an update on Investor Day. I am pleased to announce that OpenText's executive team will be hosting a virtual Investor Day on Thursday, March 11. To register, please visit our Investor Relations website or contact our IR team directly. I would also like to announce that OpenText management will be participating at the Morgan Stanley conference on March 1 and 4. We look forward to engaging with you in the coming weeks.

I will now proceed with the reading of our safe harbor statement. Please note that during the course of this conference call, we may make statements relating to the future performance of OpenText that contain forward-looking information. While these forward-looking statements represent our current judgment, actual results could differ materially from a conclusion, forecast or projection in the forward-looking statements made today. Certain materials -- 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 obligations to update these forward-looking statements, unless required to do so by law.

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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 am pleased to hand the call over to Mark.

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

Thank you, Harry, and good afternoon to everyone, and thank you for joining today's call. I want to open the call with a note of optimism. Over the last year, the world has experienced health, financial, social, political and environmental crises. Though many of these crises continue, and the effects are long-lasting and have forever, changed the way we work, live and love, green shoots are emerging all around us. With an accelerating vaccine rollout, the prospects of a global economic recovery appear to be brightening. Today, in the US, more people have received their first dose of a COVID-19 vaccine than cases reported. Economists are increasingly predicting a strong economic recovery in calendar 2021, due to a combination of rebounding demand, rising prices and low inventory levels. We're also so much better informed today than we were a year ago. The transformative nature of digital and extreme automation is clear. And we remain in the early stages of the fastest, deepest and most consequential technology disruption in the history of the world. Businesses are accelerating their digital capabilities and are placing greater emphasis on trusted global partners, time to value, modern work, sustainable supply chains, stellar customer experiences and cloud plus edge computing. What has become clear is that the cloud plus network plus edge are inextricably linked. Our new architecture and platform of Cloud Editions places OpenText information management demonstrably in the middle of important demand conversations for companies of all sizes, large, medium and small.

The previous 4 quarters at OpenText are reflective of the amazing strength and durability of our employees, our customers, our company, our business model and the transformative aspects of our products. Over the last year, we have generated a record $3.3 billion in trailing 12-month revenues, a record $1.1 billion in trailing 12-month free cash flows and invested $400 million trailing 12 months in our products, each approximately. We settled with the IRS. We increased our dividend by 15%. We announced a share repurchase program. We donated $4 million yield to help with food and security at the end of last year. We've achieved our highest employee engagement scores. We were named a Forbes top 150 employer. We delivered record fiscal 21 Q2 revenues, which we'll get to in a moment. We introduced our new platform, Cloud Editions. And we are on target to deliver adjusted EBITDA of 37% to 38% this fiscal year, and we are on target to deliver annual recurring revenues, or ARR, of 81% to 83%, highlighting 2 key aspects of our business: first, the predictability of our business; and second, we are a cloud company.

We made a statement, and it was not just words, that we would exit the pandemic stronger than we entered. The above results speak to our actions, our progress, amazing employees and our culture. Humbly, these results provide OpenText with momentum and confidence as we enter calendar year 2021, and we are excited about the significant opportunities we can pursue with our Cloud Editions.

Let me transition to our exceptional Q2. This quarter was highlighted by revenue growth, renewal rates, margin, cash flow, and positive organic ARR growth in reported currency. The team delivered an exceptional quarter. Many of our quarterly metrics are at historic highs. Let me walk through the results on a year-over-year basis.

Total revenue of $856 million, up 11%, the highest total revenue in our history; cloud revenue of $350 million, up 41%, the highest cloud revenue in our history and the largest revenue contributor; customer support revenue of $334 million, up 6%, the highest CS revenue in our history; ARR of $685 million, up 21%, the highest ARR in our history, and at 80% of total revenue; adjusted EBITDA of $361 million or 42% adjusted EBITDA margin and the highest adjusted EBITDA dollars in our history; and free cash flows of $275 million, up 46%, best Q2 FCF in our history.

Let me provide a few additional comments. The 41% growth in our cloud business was driven by our Carbonite acquisition, Cloud Editions, a rebound in our business network volumes and continued momentum in SMB-C and enterprise content services. The 6% growth in our support and update business was driven by our customer-centric 90-day release cycles and AI-informed engagement. We have over $2 billion in cash and committed liquidity at our disposal, and our consolidated net leverage ratio has declined to 1.6x this quarter, reflective of the disciplined operations post-acquisition of Carbonite.

We continue to generate growth, cash and returns in the right places. We had many notable customer expansions and wins in Q2. We have a full list in our investor deck. Please give the presentation a read, but let me highlight a few. MedPro Group, a Berkshire Hathaway company, is a national

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leader in customized insurance, claims and patient safety and risk solutions. MedPro Group is expanding its OpenText Extreme use as it continues to modernize enterprise-wide digital delivery processes.

The Department of Work and Pensions in U.K., a governmental body responsible for welfare, pension, and child maintenance chose OpenText enterprise content solutions as an integral part of their end-to-end processing for shared, critical and sensitive content.

Froneri, one of the world's largest global ice cream companies, headquartered in the U.K., expanded their commitment to OpenText's B2B managed services and engaged with OpenText to build a service offering that allows them to dynamically flex their supply chain.

Revo Health, Minneapolis-based provider health care solutions for physician practices and ambulatory surgery centers, expanded its investment in OpenText Cloud using OT2 services to securely handle confidential communications.

Before I turn to our approach of total growth in December, we announced that we closed all past, present and future items related to dispute with the IRS. As part of the resolution, OpenText will pay $299 million versus a disputed amount of approximately $830 million. While we maintain that our long-standing position in this matter was in the right, we believe the settlement to be in the best interest of all stakeholders.

Let me turn to growth and walk through our total growth strategy, which has 3 fundamental elements: retain, grow and acquire. On retain. We delivered another exceptional quarter, with customer support renewal rates at 94% and non-GAAP gross margins of 91.3%. Our cloud renewal rate, excluding Carbonite, was 96%, and our non-GAAP gross margins for total cloud of 66.7% and its margin was up 830 basis points year-over-year. We are seeing the direct benefits of leveraging more automation and automation based on OpenText Magellan and the direct benefits of scaled operations.

On growth. We continue to ramp up our investments in products and sales. We continue to grow our sales coverage of the global 10,000 customers, and we are expanding our relationships with global partners, and RMMs and MSPs. We're on track on increasing our R&D investment in fiscal '21 to support advancing the most exciting product road map in our history with Cloud Editions. For the balance of fiscal '21, our adjusted EBITDA margin will begin to reflect those increased investments.

The principles behind our Cloud Editions include: customer choice, run anywhere, number one; two, cloud first; three, simplification, 5 clouds makes it easier to go-to-market and easier to sell; the fourth principle is consumption, deeper integration of capabilities enables ease of consumption; our fifth principle is innovation, rapid and continuous innovation every 90 days to provide accelerated time to value and increased value for subscription, maintenance and our update services; and the sixth principle is to create new channels, such as our new API services to embed OpenText in the next-generation of cloud businesses, delivering our capabilities at APIs will enable developers to include OpenText and speed their time to market.

In October at OpenText World, we announced Cloud Editions 20.4, which featured our 5 clouds: content cloud, business network cloud, experience cloud, security and protection cloud and our developer cloud based on our OT2 platform. In the weeks ahead, we'll be turning on Cloud Edition 21.1, which will provide thousands of new facets, features and enhancements.

Our software development has always been deeply informed by customer feedback, and here are some highlights of upcoming Cloud Editions. In the content cloud, we now fully support all major hyperscalers, GCP, Azure, AWS, integration to SAP and Salesforce, embedded analytics. And by 21.4, the Content Cloud will be 100% recreated as a multi-tenant SaaS, public shared environment running on OT2. With Cloud Editions 21.4, customers will never have to upgrade again.

In the business network cloud, we have added support for ethical supply chains, sustainability and support for the circular economy as well as country-specific support for invoicing, tax and receiving. We now support invoicing tax and receiving in over 60 countries, enabling global supply chains that are sustainable and support the circular economy.

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In the experience cloud, we are providing superior omnichannel experiences through seamless integrations that result in enabling full social commerce and personalization enabled by technology features, in a long list of those features from notifications, messaging, document presentment and CPaaS. Opentext Magellan is not integrated for machine learning into the experience cloud.

In security and our security and protection cloud. Within BrightCloud service intelligence, we have now added cloud access security broker functionality. It's also known as CASB, to help enforce data-centric security policies and to prevent unwanted interactions. Our threat intelligence products are centered on behavioral analysis, not signatures. In 21.2, we are excited about our unified management console for RMMs and MSPs to enable complete integration of Webroot and Carbonite.

And the developer cloud. We now have over 25 live services, content service capture, signature, document presentment, intelligent viewer, workflow messaging, the list goes on, identity and threat intelligence. Our developer cloud, go check it out, developer.opentext.com, is expected to [contribute] (corrected by the company after the call) to organic growth in fiscal '22. This new strategic long-term initiative for us is to embed our services in the next-generation of cloud companies, and it will add a new channel to go to market, delivering our capabilities as APIs, will enable developers to include OpenText and speed their time to market.

Our third total growth strategy on acquire. We remain patient, disciplined, value-based buyers with returns-based metrics and cash flow as key criteria. Carbonite is a great example of a growth asset that met our disciplined value-based criteria while offering significant opportunities to create revenue growth and synergies through our cloud-based multichannel global platform. Our liquidity, cash flow and balance sheet remain strong. The pipeline is also strong, and we will deploy capital when the right opportunity arises. Our total growth strategy of retain, grow and acquire is unique, massively scalable and delivering returns. Overall, we are a company that remains on offense with the intent of taking share regardless of the economic environment.

Let me move on to financial outlook. We entered calendar 2021 with earned confidence. An improving economy coupled with the best product portfolio in our history position us to gain share by capitalizing on the present trends of digitalization, modern work, sustainable supply chains, security and cloud.

Madhu will cover the details of our financial outlook for Q3 and fiscal 2021, but let me highlight the core aspects. We are increasing the investment in our product sales and our people, we have an improved demand outlook, and we are raising our revenue growth outlook today for the remainder of the fiscal year. Cloud revenue growth now to be in the high teens, ARR growth now to be in the high single to low double digits and total revenue growth now to be in the mid-single digit, up from constant.

OpenText believes strongly in returning value to shareholders. Today, I'm pleased to announce that the Board of Directors has approved our quarterly dividend of $0.2008 per share for holders of record on March 5, 2021, and a payment date of March 26, 2021.

Let me conclude my remarks where I began, on a note of optimism. Today, we are playing offense with an improved outlook for fiscal 2021. We had an exceptional quarter with record revenue and adjusted EBITDA dollars with ARR growth of 21%, cloud growth of 41% and support growth of 6%. We have a strong balance sheet with a net leverage ratio of 1.6x, and we generated approximately $1.1 billion in trailing 12-month free cash flows. We settled with the IRS and put the matter behind us. Last year's preemptive actions are replaced with energy and growth actions. Secular trends are strong, long-lasting and OpenText is at the center of transformative discussions. We are in the early innings of an important product cycle with Cloud Editions, and our pace of innovation has never been faster with 90-day release cycles and an aggressive product road map.

On behalf of OpenText, I would like to thank our shareholders, our loyal customers, our partners and our 14,000 dedicated employees for all contributing to this success, and I am so proud of the resilience and durability that continues to be demonstrated. We are looking forward to seeing you at our virtual Investor Day on March 11. You can register on OpenText's Investor Relations website or contact our Investor Relations team directly. Investor Day is a special opportunity for investors and analysts to gain a direct update from OpenText's leadership team on our strategic progress and future direction. The team is very excited to be with you.

It's my pleasure now to turn the call over to Madhu Ranganathan, OpenText's Chief Financial Officer. Madhu, over to you.

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

Thank you, Mark, and thank you all for joining us today. We had a strong second quarter and a solid first half of this fiscal year 2021. Our preemptive responses at the onset of the global pandemic strengthened us as we continue to lead the way in modern work. Our disciplined financial management has allowed us to support key growth initiatives, maintain the resilience of our business model, and this is reflected in our expanded margins and solid cash generation.

I will speak to Q2, Q3 and our quarterly factors, our fiscal '21 total growth strategy, our fiscal '21 annual target model ranges and our long-term aspirations, all outlined in our Q2 investor presentation that is posted on our IR website today. All references will be in the millions of USD unless noted otherwise and compared to the same period in the prior fiscal year.

So let me start with revenues. Q2 total revenues for the quarter were $855.6 million, up 10.9% or up 8.8% on a constant currency basis, including a strong contribution from Carbonite as we completed the 1-year mark in December 2020. There was a favorable FX impact to revenue of $16.2 million. The geographical split of total revenues in the quarter was Americas 60%; EMEA, 32%; and Asia Pacific, 8%. Year-to-date, total revenues were $1.659 billion, up 13%, and or up 11.5% on a constant currency basis.

Q2 annual recurring revenues were $684.9 million, up 21.5% or up 19.5% on a constant currency basis. As a percent of total revenues, ARR, annual recurring revenue was 80% for the quarter, up from 73% in the second quarter fiscal '20. Here, I would like to highlight that we achieved positive organic ARR growth during the quarter on a reported basis.

Year-to-date, annual recurring revenues were $1.355 billion, up 21.7% or up 20.4% on a constant currency basis. As a percent of total revenues, year-to-date ARR was 82%, up from 76% in the first 6 months of fiscal '20. Q2 cloud revenues were particularly strong at $350.5 million, up 41.1% or up 39.6% on a constant currency basis. Our cloud renewal rate, excluding Carbonite, was approximately 96%. Year-to-date, cloud revenues were $691.4 million, up 42.4% or up 41.5% on a constant currency basis.

Q2 customer support revenues were $334.5 million, up 6% or up 3.6% on a constant currency basis. Our customer support renewal rate for Q2 was 94%. Across the business, our renewals performance remained strong. Year-to-date, customer support revenues were $663.9 million, up 5.7% or up 4.2% on a constant currency basis. Q2 license revenues were $107.3 million, down 22.3% or down 24.6% on a constant currency basis. Year-to-date license revenues were $175.9 million, down 18.6% or down 20.7% on a constant currency basis.

Q2 professional services revenues were $63.4 million, down 9% or down 11.4% on a constant currency basis. Year-to-date professional services revenues were $128.5 million, down 7.6% or down 10% on a constant currency basis.

Tax update. Before we speak to net income and other related metrics, I want to again call out the IRS settlement we announced on December 22, 2020. The IRS settlement provides finality to this long-standing manner putting it behind us as we move forward, and we believe it to be in the best interest of all stakeholders. The settlement resulted in a charge of approximately $299 million to the provision for income taxes. We expect to make payments to the IRS of approximately $287 million during the third quarter fiscal '21 and associated state tax and interest payments of approximately $12 million throughout calendar year 2021. All details are included in our Form 10-Q filed today.

Q2 GAAP net loss was $65.5 million compared to net income of $107.5 million in the prior year, primarily driven by the tax provision relating to the IRS settlement. Year-to-date, GAAP net income was $37.9 million compared to net income of $181.9 million in the prior year. Q2 adjusted net income was $260.5 million, up 14.8% or up 11.1% on a constant currency basis.

Year-to-date, adjusted net income was $502.3 million, up 25.4% or up 22% on a constant currency basis. Q2 GAAP loss per share diluted was $0.24, down from earnings per share diluted of $0.40. Year-to-date, GAAP earnings per share diluted was $0.14, down from $0.67. Q2 non-GAAP earnings per share diluted was $0.95, up $0.11 from $0.84 and up $0.08 on a constant currency basis.

Year-to-date, non-GAAP earnings per share diluted was $1.84, up $0.36 from $1.48 and up $0.31 on a constant currency basis.

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Turning to margins. GAAP gross margin for the quarter was 70.5%, up 60 basis points. Year-to-date, GAAP gross margin was 69.8%, up 120 basis points. Non-GAAP gross margin for the quarter was 77.1%, up 160 basis points. Year-to-date, non-GAAP gross margin was 76.8%, up 240 basis points. For GAAP gross margins by revenue type, please refer to our Q2 fiscal '21 10-Q report, as I mentioned, filed today.

Also, on a non-GAAP basis for the quarter, cloud margin was 66.7%, up from 58.4%, driven by continued improvement in our cloud service delivery and a strong contribution from Carbonite. Year-to-date, cloud margin was 66.9%, up from 57.8%. For the quarter and year-to-date, customer support margin was 91.2%, up from 90.7% and reflected continued strong renewal performance. For the quarter, license margin was 96%, down from 97.8%, primarily due to higher third-party technology costs, similar trends on a year-to-date basis as well.

For the quarter, professional services margin was 27.5%, up from 23.5%, reflecting benefits we see from lower travel, while effectively delivering our solutions on a digital and remote basis. Year-to-date, professional services margin was 28.4%, up from 22.8%. Please note that our total operating expenses for Q2 includes restoration of compensation and benefits effective December 1, 2020, for all employees.

Adjusted EBITDA was $360.8 million this quarter, up 13.8% or up 10.7% on a constant currency basis. This represents 42.2% margin up from 41.1% in the same quarter last year. Year-to-date adjusted EBITDA was $703.1 million, up 23.1% or up 20.2% on a constant currency basis. This represents 42.4% margin, up from 38.9% during the first 6 months of fiscal '20.

Turning to cash flows. It was consistent and solid performance with operating cash flows at $282.5 million for the quarter, up 36.3%, and free cash flows of $274.8 million, up 46.5%. On a year-to-date basis, operating cash flows were $516.4 million, up 49.8% and free cash flows of $493.4 million, up 61%. DSO was 47 days compared to 57 days in Q2 fiscal '20. The year-over-year reduction of 10 days affects continuous measures to drive operational efficiencies in our working capital framework, particularly the Quote to Collect process as well as positive contributions from the integration of Carbonite.

From a balance sheet perspective, we ended the quarter with approximately $1.5 billion in cash given our strong cash flow performance. With the $600 million revolver repayment in October 2020, we now have $750 million undrawn and fully available, bringing our total liquidity to $2.25 billion. Our consolidated net leverage ratio is 1.6x, an improvement from 1.82x last quarter. This is a strong place to be. Solid execution in the quarter and a balance sheet that positions us well to execute on our total growth strategy.

Now turning to quarterly factors, total growth strategy and annual target model all available on our investor website. So first and foremost, let me reiterate that we do view our business as annual, and quarters will vary. Long-term value is created from sustained annual performance, and 90-day cycles are way too short to measure. On quarterly factors, for the third quarter fiscal '21 and compared to the same period in the prior year, we expect the following, inclusive of FX: first of all, FX tailwind of revenues of $10 million to $15 million; total revenues, constant; annual recurring revenue, ARR, constant to slightly up; adjusted EBITDA margin percentage up 100 to 200 basis points.

For our full year fiscal '21 total growth strategy. Our first half of the fiscal year performance has been strong, particularly in the context of the global pandemic, and we are very pleased to increase our outlook for the remainder of the fiscal year. We now expect the following for our full fiscal year 2021 compared to fiscal year 2020: high-teens growth on cloud revenue compared to our previous target of mid-double digits; low single-digit growth in customer support revenues consistent with our prior target; high single to low double-digit growth in annual recurring revenue compared to our previous target of high single digits; no changes in license and PS revenue targets, which we see declining, and this is consistent with broader industry trends and as cloud adoption accelerates; total revenue move from constant to low single digits to mid single-digit growth in fiscal '21; new M&A opportunities will remain additive to our model.

Our fiscal '21 annual target model, which includes that operating ranges remain unchanged, however, I will highlight a few important points. Annual recurring revenue, ARR range for fiscal '21 expected at 81% to 83% compared to 78.2% in fiscal '20. Non-GAAP gross margin range in fiscal '21, expected at 74% to 76% compared to 74.5% in fiscal '20. Adjusted EBITDA margin range for fiscal '21, expected at 37% to 38% compared to 36.9% in fiscal '20.

On long-term aspirations, our long-term aspirations remain unchanged, targeting adjusted EBITDA margin of 38% to 40% and free cash flow of $900 million to $1 billion for fiscal '23, with a plan to reinvest any margin gains above 40% into additional growth initiatives.

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In summary, well done to the OpenText team for delivering a solid Q2 and leading the way in digital working. As January 2021 rolled in, the OpenText team brought forward tremendous learnings and resilience as we look ahead to the second half of our fiscal year, a very special thank you for your amazing efforts. Our thank you to our shareholders whose trust and confidence we greatly value. We look forward to engaging with all of you as part of our investor outreach and conferences and of course, at our March 11 Investor Day. I wish you all continued safety and wellness.

I would now like to open the call 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 from me on a great quarter. Mark, you talked a little bit about the recovery or the green shoots of recovery you see everywhere. And it's great to see the guidance because now it's fully organic, what we see for next quarter. If you think about the next few quarters, looking out and the guidance you've given here, is that kind of the new normal? Is there an element of recovery in there so that it's better than normal? Like how do we have to think about it, what you're seeing there? And then I have one follow-up.

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

Yes. Thank you for the question. Look, the -- if I wind back to a year ago, our energy was very much on our preemptive sort of decisions that ultimately strengthened us through the year. But if I look at the year ahead, and certainly for the remainder of the fiscal year, which is through end of June, we see those green shoots. I mean there are 4 things that come to mind. The first is modern work is really accelerating, content management, workflow, e-signature, projects and collaboration. Second is we see this rebound of our business network volumes and industries that are seeing an increase. Health care, automotive, retail, a lot of green shoots there for us on the business network. Security has come front of mind post SolarWinds and our ability to really provide data protection and the next-generation of threat intelligence based on behaviors for signatures. Then Raimo, you have all the, I think, the secular things around movement to cloud and the need to have that trusted partner on a global basis. So we feel like very sustained trends coming into the calendar year. And we've had 4 quarters of experience through the pandemic, and each quarter has been getting sequentially stronger. So that's part of the reason for a bit more visibility into the fiscal year as we come into the second half. And welcome your second question.

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

Yes. Okay. Perfect. And then on the cloud. So we now -- we're talking 21.2 and 21.4. Sounds like you're really excited when it comes out. What do you see in terms of customer interest in terms of how they are kind of migrating over to the cloud? Is that -- do you see like new workloads going into the cloud and the existing stuff is still kind of staying on-premise? Do you see migration starting? What's the momentum that you're seeing there?

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

Yes. Thank you for that. Look, at Investor Day, I plan to go much deeper on the kind of the status of Cloud Editions. But let me just give you a few examples. I look at our content cloud and support for modern work. We have new workloads and expanded work going on at the NIH in the U.S. and European Central Bank. On the experience cloud, we have a new customer like PG&E and expanded workloads for social commerce at L'Oréal. On the business network side, we're very excited about -- I know we're all very focused on the pandemic and rightfully so, but the greater challenge

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is really the environment in the circular economy. So our work in supporting very demonstrable features to support that circular economy with customers like Nestlé. Our protection cloud, doing work with Hyatt, Thomson Reuters on our security and protection cloud. And I'm really excited about how the developer cloud, everything as a public API is going to contribute to organic growth in fiscal '22. So it's all about the Cloud Editions. I think it's a mixture of taking off-cloud current workloads to a private managed service, it's about adding new workloads in our SaaS offerings, it's attracting new customers and also a new market of our API services. And I'm going to -- I plan to go in a lot more detail at Investor Day.

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*

I was hoping you could talk a little bit about which pieces of the cloud kind of drove that outperformance versus prior expectations. Did you see kind of outsized growth in Carbonite or CE or business network? So how to kind of think about that outperformance on cloud this quarter?

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

Yes. I would -- I'd point to 3 pieces. On the content side, in the content cloud, again, for the reasons I just previously talked about, support for modern work. Second is the business network and the increase in volumes and nice new green shoots in a variety of industries. And Carbonite overall, just had a strong quarter from the data protection Carbonite side, Webroot and threat intelligence as well as BrightCloud. So those are the 3 standouts, Stephanie. I'd point to the content cloud, business network and Carbonite in general.

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

Okay. That's helpful. And within Carbonite, kind of thinking about the upside opportunities here and the cross-selling into the enterprise and the extension of the partner network. Just curious where we are in those initiatives. Or the outperformance in Carbonite was really more a function of just the existing prosumer/consumer market kind of driving that sale?

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

Yes. There are 3 drivers. The first is just better running the existing business. And it is a unique go to market. And this is where we sell to, we enable, we deploy to RMMs and MSPs. We don't really -- we don't -- we, of course, sell to some SMBs directly. But the vast majority of our business is through RMMs and MSPs, and it's a very unique channel. I know others are claiming they invented it, they didn't, that's okay. But our business is through this very unique channel. So one, growth is just better managing that. Two is increased innovation. I'm very excited about of 21.2 in an integrated console that delivers on the promise of integrating Carbonite and Webroot to move through that channel of RMM and MSP. The third is uplifting, kind of upselling, upscaling the product into the enterprise. And we started to see some green shoots there. I mentioned a few names, TD Securities, Hyatt, Thomson Reuters, Prudential, who are using a mixture of Carbonite data protection or BrightCloud. So those are the 3 approaches, Stephanie, that we're looking to grow. It's just better managing the platform to RMMs and MSPs. It's two, accelerating innovation, things like CASB, things like an integrated console, next-generation of threat intelligence, continuing to focus on behaviors for our signatures. And then what I call is upscaling the product into the enterprise, and we've gone to see some green shoots on the enterprise customers I just mentioned.

Operator

Our next question comes from Paul Steep of Scotia Capital.

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

Mark, maybe you could talk just following up on the content cloud driving growth. Can you give us a sense of what that multiyear migration cycle might look like? I know that might be taking some of the excitement from the March day, but just in any context of where we are? And then I have one quick follow-up.

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

Yes. My team's strongly encouraged me to save the gunpowder for Investor Day, if you will. But let me say it this way, Paul. We are in literally the earliest of innings, truly are. We're less than 10% migrated of our install base into our 5 clouds. So it is still the earliest of innings to have our install base fully on the Cloud Editions architecture and platform. And it's not just a lift and shift of the platform. We can manage it better, we can manage it at a lower price, but we want to bring them to a modern environment. We want to manage the application stack. We want to be able to expand workloads. We want to be able to bring them to all of information management. So I would just summarize that we're in the literally earliest of innings, we're less than 10% migrated on cloud. Look, Cloud Editions has only been in the market just a little over a year. So it remains the largest, the single largest opportunity we have to drive growth is to migrate our install base.

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

Great. On risk of wearing out my welcome here, how should we think about longer term...

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

Never.

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

As we sort of move over from cloud, how should we think about that license line? Or maybe how are you managing that transition to make customers more or less agnostic about the purchase decision?

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

Yes. Thank you, Paul. I think you'll notice I didn't use the word license at all in my script. And the emphasis is all on cloud. Let me point to a few things. The first is our annual recurring revenue, ARR, with 80%. It's all about our business, but when you benchmark us to Oracle, Microsoft, IBM, SAP, we are ahead of every one of those in terms of our transition to ARR. We're at 80%. We have a -- our target model is 81% to 83% for the year. But you look at established companies like IBM, Microsoft, Oracle, SAP, we're ahead of every single one of them in where we are at ARR as a percent of our business. Second, I'd point to our support business, which is a support and update business, the ability to get security updates, the ability to get rapid new features that are relevant and easy to consume, that business grew 6%, as we noted. So our strategy is let customers decide, it's customer choice of how they want to consume. I said this many years ago, I am agnostic as to how they want to consume. We are opinionated on growing our margin. As you can see through the years that we're not agnostic there. And we've -- we're just going to grow cloud faster than everything else, as you're seeing. So customers still have the choice. It's clearly cloud first. ARR is leading and dominating. We're ahead of our peers, and we're simply going to grow faster in cloud and ARR versus that transactional side of the business.

And Paul, if I can, maybe before we get to the last question, I just -- we don't philosophically believe that we should force it because it's still customer choice. And some companies are forcing it. But they're also at a lot lower ARR than we are. And so it's really the ARR piece that is really a standout at 80%, not just at OpenText, but when measured to our peers.

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Operator

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

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

Mark, how would you characterize the customer buying behavior in terms of sales cycles, decision processes, deal sizes, is it starting to look a lot more similar to pre pandemic? Or are we still in kind of a weird environment in that regard?

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

I would say it's returning. It's not fully back to pre-pandemic, but it's a lot less uncertain in bureaucratic than it was maybe in the first half of last year. There is no doubt a greater emphasis, and I think this is new, so it's not pre-pandemic or during pandemic, I just think this is new, it is an emphasis on time to value. That there's an immediacy, there's a time to value and it's also a look to global trusted partners versus -- so less risk adverse. So it's a good question. Deal sizes, I think, are slightly up. I think decision cycles are slightly shrunk. It's -- I wouldn't say it's fully back to pre-pandemic, but it's more there than not and time to value is certainly emphasized in the majority of our transactions today.

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

Great. And then a question for Madhu. As I look at your guidance and your target model for the year, that would seem to imply a fair bit of gross margin compression in the second half in professional services and cloud. And so maybe just to clarify, would that be a function of comps being restored at prior levels, an expectation of travel expenses going up? Or maybe just conservatism on your part?

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

So thank you for that. So definitely, as Mark also alluded, we are investing in the second half, and we're investing not just putting comp back, but also in terms of hires, and building up for the next year. And from a gross margin perspective, that also includes investment in cloud services and customer support as well.

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

Presumably, maybe to improve the capacity, right? (inaudible) capacity, would that be fair?

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

Yes, and that would be fair as well. Yes.

Operator

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

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

With respect to the shift here to the cloud, I'm just kind of curious, is there an opportunity to kind of create a bit of a step function up in terms of organic growth with that transition here?

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

Richard, thanks for the question. As we noted in our script, we had in the quarter, organic ARR growth in reported currency. And I expect to have organic growth in the cloud in the second half of the year. In terms of a step up, we'll maybe talk more about what that means, but I'm expecting cloud to grow organically, just to say it directly based on the factors we talked about.

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

Okay. Yes. I'm just asking because I was sort of looking at Slides 21 and 24, where you highlight your customers and a number of products that they're signed up for. And it seems like they're signing up for more. And I guess the line of question was around as these platforms become more uniform, the ability to sell into that base, I would think should be easier no? Which is why I'm asking a question, but anyway.

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

Yes. Look, and if I can, I'll point to the principles I talked a little bit about, and there are important principles behind Cloud Editions. I think that's partly of what you're noting that once migrated into the OpenText Cloud, we have the ability to deploy the features for customers, and they don't have that friction in the system, right? The more integrated we get, again, the less friction to more modules. And as we get to more standardized product, the ease of both consumption and new modules. So it's no doubt that Cloud Editions and running the cloud is going to give us the opportunity because of the integration to deploy more capabilities and to have customers be able to consume more.

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

Okay. That makes sense. With respect to the acquisitions, I know you talked about it as one part of your growth strategy. What does that environment look like today? And I guess related to that, are you looking to sort of fortify the markets that you're currently in? Or would you kind of look at it expanding in new markets, sort of like what you do with Carbonite and security?

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

Yes. Well, let me take it as an opportunity, I'll answer the question directly, but I'm going to take it as an opportunity to highlight how we believe we create value. Number one, these are co number ones, number one number one, organic growth and that's top of the list. And as we look into the remainder of the second half of the fiscal year and the calendar year, we're clearly emphasizing organic growth today and also the step-up in our outlook. Secondly, number two of number one is margin. And we've just been on a stellar track to continue to become more efficient, more productive as a company. And then thirdly, the third number one is capital, capital deployment and capital efficiency. We're very focused on the capital we've deployed. Getting full value for Carbonite, getting full value for Liaison. Documentum wasn't that long ago. And Documentum puts us right in the middle of modern work for a lot of companies. And then there's new capital deployment. And on the new capital deployment, which was, I think, part of the basis of your question, is we're going to remain a value buyer. We have the management and leadership bandwidth. We have a net debt ratio of 1.6, approaching sort of recent lows, if you will. And I'm very happy with the markets we're in today. So I'm not looking to create a new market, Richard, but rather kind of gaining share in what we have.

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

Okay. And just one last one related to acquisitions. Is your comfort level on leverage ratio, I think it was in the mid-3s, if I like -- if I recall, but I'm not sure what it is today. Is it still around there?

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

Our net leverage ratio is 1.6 today. And as we've noted, we've chronicled historically that we'd be comfortable ideally, we're at 3, but we'll go above 3, if we need to and then rapidly decrease that. And I'll point, again, to Carbonite as well as Documentum, where we rapidly delevered. Look, we -- 3 is where just -- I think of it simply that if the world goes really bad, like they'll pay off my debt in 3 years. That's why that's sort of a 3x ratio. It's a relatively conservative ratio. Our covenants allow us to go higher than that, but we like operating around 3. We're well below it. And if we need to go above 3, we won't be bashful for the right asset, but it will come with a rapid deleverage plan. And as we've demonstrated, we can do it and have done it with Carbonite and Documentum.

Operator

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

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

Just wanted to hone into one product area, in particular, which is e-signature. It seems like that is probably one of the products that's been seeing strong adoption in this environment. Now how do you see it within the large enterprise deals? Like is it bundled in there? Or can you sell it as an incremental product offering? And the reason I bring it up is some of your competitors are doing quite well selling signatures or digital signatures. So should we expect similar growth? Or are you seeing similar growth with your own product there?

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

Yes. Paul, thank you for the question. We're excited about it, and we sell it independently. We bought the source code to a company about a year ago, and we created a product about 1.5 years ago, we created a product and a service. And it's now fully integrated to content services, and it's now a stand-alone product. So we're -- we expect -- it is contributing. And we're fully able to sell it as an independent module. And it is an important part of modern work, part of workflow, part of collaboration, project management and ultimately, signatures. I'll highlight one customer, fully live, we're doing tens of thousands of signatures a month, the Government of Ontario, who are fully live on our e-signature product.

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

And this relates to the e-signatures, but with the market e-signature, at least, it seems like a lot of the growth is coming from SMB. It seems like there's other product categories, you look at like file sharing and whatnot, where the growth has been driven by SMBs. With the launch of your 21.4 product, multi-tenant SaaS and public cloud, does that potentially open you up, open OpenText up to going direct in terms of addressing the SMB market?

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

We still have -- in all our progress, we still have much to learn. We bring e-signature to the enterprise. We haven't brought e-signature to SMB. So our e-signature success is through our enterprise sales force. And this is one of the reasons we really love Carbonite because we see a lot of these solutions that are built both to scale up into the enterprise and scale laterally into SMB. And as part of our great long-term growth prospects is to be able to get that multichannel way to market really humming. So we now have our product like e-signature for the enterprise, but we haven't brought it into the SMB world yet. So I mean, I appreciate your comment, but it just highlights why we brought on Carbonite and the opportunity for many of our key solutions. And it's one of the things that as part of our strategic direction is able to bring product simultaneously to the enterprise and SMB, and we have a lot of learning to do there and lots of opportunity.

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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*

All right. Well, thank you very much. We're obviously very excited about Q2 and playing offense and our improved outlook for fiscal '21. I hope -- we hope to see everyone at our Virtual Investor Day on March 11. Please register on our website or contact Investor Relations, and the team is very excited to spend time with you to talk -- to provide updates on our strategic progress and our future direction. Thank you for joining us today.

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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