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PRESENTATION

Operator

Thank you for standing by. This is the conference operator. Welcome to the OpenText Corporation Third Quarter Fiscal 2024 Financial Results 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

Good afternoon, everyone, and welcome to OpenText's Third Quarter Fiscal 2024 Earnings Call. With me on the call today are OpenText's Chief Executive Officer and Chief Technology Officer, Mark J. Barrenechea; and OpenText's President, Chief Financial Officer and Corporate Development, Madhu Ranganathan. Today's call is being webcast live and recorded with a replay available shortly thereafter on the OpenText Investor Relations website.

Earlier today, we posted our press release and investor presentation online. These materials will supplement our prepared remarks and can be accessed on the OpenText Investor Relations website, investors.opentext.com.

I'm pleased to inform you that OpenText management will be participating at the following upcoming conferences: Needham Technology, Media, & Consumer Conference on May 14 in New York, Barclays Leveraged Finance Conference on May 21 in Austin, CIBC Technology & Innovation Conference on May 22 in Toronto, Jefferies Software Conference on May 30 in Newport Coast and Bank of America Global Tech Conference on June 6 in San Francisco.

And now on to our safe harbor statement. During this call, we will make forward-looking statements relating to the future performance of OpenText. These statements are based on current expectations, assumptions and other material factors that are subject to risks and uncertainties, and actual results could differ materially from the forward-looking statements made today. Additional information about the material factors that could cause actual results to differ materially from such forward-looking statements as well as risk factors that may impact 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 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 direct comparable GAAP measures may be found within our public filings and other materials, which are available on our website.

And with that, I'm pleased to hand the call over to Mark.

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

Thank you, Harry, and welcome to today's call. Let me kick off the call with a statement. The strategic value of OpenText to our customers has never been higher. We continue to build cloud momentum with our business clouds, business AI and business technology. And we see proof points of this as evidenced by our continued strength with large multiyear cloud contracts and our upward revisions in future cloud bookings expectations. And with the AMC divestiture now complete, we have increased our capital flexibility to accelerate growth in the \$200 billion information management addressable market.

Long term, we expect our business to deliver mid-single-digit total revenue growth through a balanced approach of cloud-led organic growth plus M&A comprised of 20%-plus enterprise cloud bookings growth, 7% to 9% organic cloud growth, 2% to 4% total organic growth and 1% to 2% M&A growth. Powerful cash flows at 20% plus of revenues and a new return on capital framework comprised of 50% of trailing 12-month free cash flows returned to shareholders in the form of dividends and share buybacks and 50% for cloud M&A.

And to jump-start this new return of capital program, we are announcing today a \$250 million share buyback over the next 12 months and our intention to return \$450 million to \$500 million of capital to shareholders in fiscal '25. Let's get started.

You'll see in our investor deck today our 4-point strategy to building shareholder value. Point one of the strategy is to continue to live the OpenText Business System with a relentless focus on execution. Simply said, an OpenTexter always puts customers first, innovates, cares about people and strives for exceptional performance. Our culture sets us apart.

Point two, accelerate cloud growth. Our strategy to accelerate cloud growth is working. We've increased our R&D investment to an annualized \$900 million or 16% of fiscal '24 revenue. This helped drive enterprise cloud bookings growth of 63% in Q2 and 53% in Q3. We've increased our F'24 enterprise cloud bookings targets to 33% to 38%, and we're confidently projecting 20%-plus cloud bookings growth in both F'25 and beyond, up from prior target of 15%.

We expect our cloud revenue organic growth to reach between 7% and 9% by fiscal '27, and the best part is we're just getting started in our AI and security journey. The OpenText Cloud opportunity continues to expand across our business clouds, business AI and business technology. We are well aligned to Gartner and customer spending priorities in cyber, information security, data, cloud platforms and AI. We're focused on winning more workloads for knowledge workers, business networks, customer experience and digital operations. We're helping customers build and own their own capabilities in the private and public cloud and to do so securely. We're unlocking new developer opportunities in large-scale software companies. And let's understand it, we're all software companies today, and we're rapidly adding IoT and AI capabilities.

We see two huge opportunities in AI. First, to help our large installed base of customers prepare their operations and data through systems consolidations to our Cloud Editions; and second, to grow our Aviator Thrust offerings. We officially introduced Titanium X at OpenText World Europe a couple of weeks ago, our next-generation autonomous cloud. We demonstrated our latest Aviator technology with Cloud Editions 24.2. We made business AI as easy as pressing a button. And we made clear the step function to productivity a knowledge worker can gain with learning models applied to information management.

Customer and analyst feedback is extremely positive. And while many customers are still researching and piloting, Aviator is helping us win now. We have unique capabilities to move enterprises into actionable business AI use cases to securely exploit both unstructured and structured data and accelerate customer value through partnerships like SAP, Google and Microsoft.

Consider Pick n Pay leveraging DevOps Aviator for scaling, testing and quality; a leading global apparel company, accelerating invoice intelligence with Content Aviator; Zurich Airport leveraging our SaaS service management and Universal Discovery in the cloud. Please watch on opentext.com the recap of our OpenText World Europe, where I demonstrated OpenText Content Cloud 24.2 with Content and Search Aviator running the United States National Transportation Safety Board (corrected by company after the call) data archive. It shows the power of automation plus AI providing clear and bankable productivity gains for any knowledge worker. You can also hear directly from our customers of Nationwide, Carl Zeiss, Uniper, Fratome and Criteo at the event.

Point three of our 4-point strategy, powerful free cash flow generation. We are targeting an F '24 free cash flow of \$725 million to \$800 million, and our medium-term aspiration by fiscal '27 of \$1.2 billion to \$1.3 billion or 20% plus of free cash flow as a percent of revenue. We expect to achieve these higher free cash flow aspirations through a series of actions, adjusted EBITDA margin expansion from a technology-enabled business through leveraging our data, automation and AI. We are just getting started in deploying AI internally. Completing all Micro Focus integration expense, lower special charges over time, lower interest charges and potentially lower rates over time. It is a combination of margin expansion, more technology enablement, elimination of integration expense and a reduction in interest burden that is the path to our free cash flow aspirations.

Point four, disciplined capital allocation. We expect to pay down our debt on May 6 by USD 2 billion, and with our net leverage ratio now below 3x, we are increasing our return of capital to shareholders by introducing a \$250 million buyback and reentering the M&A market with a new framework that is future oriented, while leveraging the best parts of our operational discipline. You will see in our investor presentation today our capital allocation strategy comprised of 2 elements: primary and additional allocation.

For the primary, we intend to allocate 50% of our trailing 12 months free cash flow to dividends and buybacks. We have a strong dividend track record, as you know, returning \$1.9 billion over the last decade. I'm now pleased to add a buyback program to that return strategy. As noted, our target is 50% of trailing 12 months free cash flow allocation, and we're going to start higher with a \$250 million buyback, and we intend to return again between \$450 million to \$500 million to shareholders in fiscal '25.

For the additional part, we intend to allocate the other 50% of trailing 12-month free cash flows to cloud-based M&A. Further, we are excited about the M&A opportunity for information management in the cloud for higher recurring revenues. We intend to cast a wide net across information management for established technologies with proven customer value propositions.

We are looking for small- to medium-sized cloud companies that will benefit from our business system, general operations, benefit from our distribution and benefit from our multibillion-dollar cloud foundation and cloud operations. We'll always seek value in organic growth. You can expect us to complete multiple M&A transactions in the coming year while growing organically.

Let me turn to our financials and our medium-term aspirations. For Q3, our results reflect strong execution and strong customer trust. On cloud bookings, \$165 million, up 53% year-over-year. We more than doubled our \$1 million-plus wins year-over-year, from 13 to 28. Average cloud deal size is up 30%. Contract terms are longer. Customers are increasing their commitments for long-term durations with ramps to full value. Our investment is also up to fuel that growth, to get customers ramped and to introduce new capabilities like AI and IoT.

We had total revenues of \$1.4 billion, up 16% year-over-year. We ended cash of \$1.1 billion and free cash flow of \$348 million, up 14%, and just had fantastic wins at Akamai, Nestlé, Shell, Tyson Foods, BAE Systems and MAN. Recall, we're an annual business. And for full fiscal '24, our targets include cloud bookings growth between 33% to 38%, 6% to 8% cloud growth, total revenues between \$5.745 billion to \$5.795 billion and free cash flows between \$725 million to \$800 million, up from \$655 million last year.

Today, we're also presenting preliminary F '25 targets and subject to change. These preliminary targets are without the AMC business. We're expecting enterprise bookings of 20% plus, cloud revenues of up to \$1.9 billion, total revenues between \$5.3 billion and \$5.4 billion, free cash flows between \$575 million to \$650 million, which includes, really important, which includes a onetime \$250 million tax payment for the AMC divestiture.

Excluding our tax payment from divestiture, our free cash flow would be growing again year-over-year. And Madhu will talk more about this. And again, a return of capital between \$450 million to \$500 million.

We're excited about our cloud business, Cloud Editions, Titanium X, our next-generation autonomous cloud, security, SaaS and aviators. Our cloud bookings are strong and growing faster than the market and is a leading indicator of our cloud momentum. We're also maintaining our medium-term aspirations but moving them from '26 to '27. Why?

Customers are trending more and more to sign larger contracts with longer-term commitments of 4-plus years that also include ramps. This is driven by industry trends and our strong multiyear road map of capabilities. This is positive news. Customers are increasing their commitments to OpenText for longer durations. You also see this positive trend from other cloud providers such as SAP, Google, Microsoft and AWS, our most important partners.

Our F'27 aspirations include: enterprise cloud bookings of 20% plus; total revenues of \$5.7 billion to \$5.9 billion; cloud organic growth of 7% to 9%; total organic growth, 2% to 4%; adjusted EBITDA of 36% to 38%; and free cash flow between \$1.2 billion and \$1.3 billion, reflecting strong continuous growth, and M&A will contribute to these aspirations.

Well, let me wrap up and thank you for joining today. And let me conclude my remarks where I started. The strategic value of OpenText to our customers have never been higher. We're increasingly confident about our business, our ability to grow in the cloud and produce higher profits from these higher revenues, and that's reflected in our increased visibility today that we are providing.

To recap, OpenText has a highly attractive financial model with a predictable, resilient and growing revenue stream, upper quartile adjusted EBITDA margins and growing free cash flows and a very strong balance sheet. Our 4-point strategy is designed to build shareholder value and to create a long-term recurring revenue and highly profitable business model, and we're excited to reduce our debt by \$2 billion, execute to a \$250 million buyback and a new return of capital strategy, return to M&A and deliver a stellar F'24 of 6% to 8% cloud growth.

I want to express my deepest appreciation to the entire OpenText executive team and my colleagues for always putting customers first, innovating, caring about people and for their exceptional performance. I'm delighted to welcome Todd Cione, President of Worldwide Sales, responsible for all new sales. Let me congratulate Paul Duggan, President and Chief Customer Officer, responsible for all renewals, professional services and support. And to Madhu Ranganathan, President and CFO, responsible for finance, operations and corporate development. Please visit opentext.com to read about our exceptional leadership team, ready for the next growth chapter in our business clouds, business AI and business technology. May the one that brings peace bring peace for all.

And let me turn the call over to Madhu. But before I do, I want to wish Madhu a very happy birthday today. Madhu?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Great. Thank you, Mark, and we appreciate all of you joining us today. So let me start with a few key points. In Q3, we successfully achieved our operating goals while focusing on initiatives for growing our cloud business. This was our 13th quarter of organic cloud growth. We announced yesterday, May 1, that we have successfully completed divesting the AMC assets. This transaction returns us to capital flexibility. Last quarter, I mentioned that Micro Focus will be on our operating model, both adjusted EBITDA and free cash flows as well as returning to organic growth by the end of fiscal 2024, we are on track to achieving that. Our outlook, targets and aspirations fully reflect the opportunity in front of OpenText with enterprise cloud bookings leading the way as our customers prepare for AI. Mark spoke to our Q3 results, and let me share some additional comments.

During the call, I will refer to the investor presentation posted on our IR website. All references are in millions of USD and compared to the same period in the prior fiscal year and are on a reported basis, unless stated otherwise. On a year-over-year basis, Q3 cloud revenue was \$455 million, up 4.4% as well as 4.4% in constant currency. Our enterprise cloud business is doing extremely well with 53% year-over-year bookings growth in the quarter, increasing our visibility towards cloud revenue growth. Q3 ARR, annual recurring revenue of \$1.146 billion, up 13.3% and 13.1% in constant currency, that represents approximately 79.2% of total revenue.

And now moving to other financial metrics. GAAP net income was \$98.3 million, reflecting increased interest expense, amortization and special charges that relates to the broader acquisition of Micro Focus, driving GAAP EPS of \$0.36. GAAP gross margin of 73%, up from 70.3%, also reflecting a healthy revenue contribution from our customer support and license businesses. Non-GAAP gross margin of 76.7%, up from 75.8%, also reflecting increased relative contribution from a revenue standpoint from customer support and license.

Adjusted EBITDA, \$463.7 million, an increase of 27% and 26.4% in constant currency. Our adjusted EBITDA margin was 32% as we continue to make solid progress bringing Micro Focus to our operating model. Adjusted EPS was \$0.94, was up 28.8% and the same in constant currency. Our overall working capital performance remains strong with our DSOs at 45 days, that was consistent with Q3 of the prior year. We generated \$384.7 million in operating cash flows and \$348.2 million free cash flow in the quarter.

Turning to the balance sheet. We finished Q3 with \$1.125 billion in cash. Our net leverage ratio on March 31 was 3.8x. With the successful completion of AMC divestiture, we have provided notice of our intent to prepay \$1.060 billion of the acquisition term loan as well as to prepay in full the \$940 million outstanding principal balance of the Term Loan B. That is a total of \$2 billion debt repayment that we expect to make on May 6, which will bring our net leverage ratio to less than 3x. The repayment will reduce our debt from \$8.5 billion to \$6.5 billion and our annual interest expense from \$537 million to \$383 million, a reduction of \$150 million. We're extremely satisfied with the outcome and well positioned to execute on our capital allocation program given this flexibility.

Now regarding M&A, our capital allocation model leaves ample room to invest in strategic M&A to drive future cloud growth. In my expanded role as President, I'm excited to lead our corporate development function. As Mark noted, we expect to do multiple deals, targeting small- to medium-sized cloud businesses. We have fully outlined our cloud M&A strategy on Page 26 of our investor deck.

Turning to the dividend program. On April 30, the Board of Directors also approved a quarterly cash dividend of \$0.25 per common share. The record date for the next quarterly dividend is May 31, 2024, and the payment date is June 18, 2024.

OpenText ex AMC. Yesterday, after we announced the divestiture completion of AMC business, we also filed pro forma statements to provide the historic view of how our business looked from July to December 2023 without AMC. I'll walk through a few points to ensure your financial models and year-over-year comparisons are accurate. Please also refer to Slide 32.

For fiscal 2023 actuals, AMC revenues approximately \$225 million and primarily representing the 5 months of AMC business since original close of acquisition. For fiscal 2024, AMC business annualized is approximately \$528 million of revenue. Given completion of divestiture on May 1, earlier than our previous target of June 30, 2024, we're reducing our fiscal 2024 target model by approximately \$100 million, the expected AMC revenue contribution for the months of May and June 2024. There will be no AMC revenues in fiscal 2025 and beyond.

And now let me turn to our outlook, starting on Page 36. Starting with our Q4 fiscal '24 quarterly factors in our investor presentation. Revenue on a year-over-year basis, we expect \$1.39 billion to \$1.44 billion; ARR of \$1.08 billion to \$1.12 billion, a slight FX headwind; adjusted EBITDA margin between 32.5% and 33.5%. Our assumptions today include the following: AMC divestiture closed as of May 1 and removing 2 months of AMC business from Q4, including a reduction in Q4 and fiscal '24 revenue of approximately \$100 million, as I mentioned earlier; AMC divestiture-related expenses now included in Q4.

And regarding our cloud business, we now have a second consecutive data point with strong cloud bookings of 53%, growth in the third quarter and greater than 60% growth in our second quarter. The longer-term customer commitments and ramps we are seeing are now factored into the Q4 revenue projections. We have also now further increased our cloud investments in SaaS, in IoT and security.

Last is our AI and customer investment, which are further increased in Q4, as we see continued benefit to cloud bookings. Our fiscal '24 target model in constant currency is provided on Page 38. So building on my prior comments, the target model ranges for fiscal '24 reflect only 10 months of contribution from AMC.

Total revenues between \$5.745 billion to \$5.795 billion; total revenue growth of 27%, with organic growth in the range of 1% to 2%; cloud revenue growth, 6% to 8%; enterprise cloud bookings growing 33% to 38%; annual recurring revenue up 23.5% to 25.5%; adjusted EBITDA margin in the

range of 33.5% to 34.5%, again, reflecting higher investments in AI and cloud sales and marketing, expenses related to the AMC divestiture and Micro Focus integration expenses.

We expect full fiscal '24 free cash flows of \$725 million to \$800 million, again, reflecting AMC divestiture closed 2 months earlier than expected. This excludes 2 months' cash flow we would have seen from AMC of approximately \$50 million and divestiture-related expenses of \$40 million with a slight positive offset of lower interest.

On Page 39, we have laid out our preliminary fiscal 2025 targets and fiscal 2027 aspirations. As Mark mentioned, we're maintaining our medium-term aspirations but moving from fiscal '26 to '27, driven by the cloud acceleration of our business. We now have increased our expected growth in cloud bookings to 20% plus annually. We continue to watch the markets closely on interest rates and currency, noting that our long-term models today do not assume any interest rate benefit or improvements in the euro or the yen. Both will positively benefit our model should they materialize.

We expect total revenue in fiscal '25 to be \$5.3 billion to \$5.4 billion in constant currency with cloud growing to \$1.85 billion to \$1.9 billion. Our adjusted EBITDA will be lower in the 32% to 33% in fiscal '25, and that reflects spend on our cloud and AI growth programs as well as some trailing expenses from the Micro Focus acquisition. Free cash flows in fiscal '25 will be in the \$575 million to \$650 million range and includes a onetime tax payment of \$250 million relating to the gain on AMC divestiture. Without the tax payment, FCF in fiscal '25 will grow year-over-year. The tax payment is expected to be made in Q1 of fiscal '25 and will be reflected in our Q1 and fiscal '25 free cash flows. The path to our fiscal '27 free cash flow aspirations of \$1.2 billion to \$1.3 billion is highlighted on Page 24 of our materials. Our goal to improve free cash flows to 20% of revenue supported by greater scale and efficiencies, including automation and AI. An example is Project Athena utilizing our own AI technology to automate development.

The following key improvements in fiscal '27 creates a clear path in our planning towards reaching these 2027 aspirations. Adjusted EBITDA margin expansion of 36% to 38%; interest expense post deleveraging coming down approximately \$150 million; special charges reduction down approximately \$30 million; and a onetime \$250 million AMC tax charge that will be completed in fiscal '25. With all of this, we expect continuous future year-over-year growth in free cash flows.

So in summary, when we talk about the OpenText financial profile, investors should think about a mid-single-digit growing software company, led by cloud revenue growth plus small- to mid-cloud M&A. Shareholders can expect us to complete M&A transactions in the coming year. We have established our return on capital framework to complement our dividends previously at 20% of trailing 12-month cash flows to 50% overall return on capital by leveraging a new share buyback program. We raised enterprise cloud bookings from 15% to 20% and have a clear path to growing free cash flows to 20% plus of revenues in fiscal '27. On behalf of OpenText, I would like to thank our shareholders, our loyal customers and partners and to all the OpenText team members.

I will now request the operator to open the call for your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Daniel Chan of TD Cowen.

Daniel Chan - TD Cowen, Research Division - Director

Just want to get some clarification on the pushout of the midterm aspirations from fiscal '26 to fiscal '27. It sounds like there's a lot of demand, a lot of strength, a lot of traction here. Just trying to understand why that pushes the aspirations out a year rather than pulling it forward.

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

Yes. Dan, Mark here. Thanks for the question. I'll just start obviously with the headline, which is we're divesting \$528 million of revenue via the divestiture. And as I noted in my remarks, we're signing larger, longer-term cloud contracts that have ramps in them, ramps to full value, supported by strong multiyear road maps.

We're also seeing and hearing from others in the industry like SAP, Microsoft, Google, who are seeing various trends. Now we have various accelerants that are not factored into those aspirations yet like faster cloud adoption, aka, can we grow faster than 20% and can we get faster ramps? We haven't factored in yet AI taking off. We haven't factored in M&A. We haven't factored in the euro rebounding and helping customers spend more in euro, if you will. So those are the reasons for maintaining the aspirations, but seeing them as part of F '27, not part of F '26.

Daniel Chan - TD Cowen, Research Division - Director

Okay. And then on the margin guide for next year, if I back out AMC from fiscal '24, it looks like EBITDA margin this year is expected to be about 32.5% as well based on your fiscal '24 targets. So you called out additional AI investments, AMC divestment having an impact on some of those margins.

Can you help break down what is driving -- how much is coming from each of those? How much more are you accelerating R&D for AI investments that's causing that flattish EBITDA margin trajectory versus how much of it is going to come from additional expenses from AMC divestment?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. Thank you again. The AMC divestiture expenses are predominantly in Q4. And your question is about fiscal '25, the categories would be, as I mentioned earlier, it is certainly investing towards the cloud bookings growth, and you'll see those investments predominantly in cost of sales and some below the line as well. When it comes to below the line, yes, we are absolutely investing in R&D line as well as sales and marketing. But also keep in mind, fiscal '25 adjusted EBITDA is growing from a year-over-year perspective.

Operator

The next question comes from Steve Enders of Citi.

George Michael Kurosawa - Citigroup Inc., Research Division - Research Analyst

This is George on for Steve, and congrats on a great quarter. A lot going on, not least of which happy birthday, Madhu.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Thank you.

George Michael Kurosawa - Citigroup Inc., Research Division - Research Analyst

Maybe just to start, the cloud bookings number, second really impressive growth number, obviously impacted by duration and maybe bumped up your long-term target to 20%. Maybe if you could just help us kind of tease apart, bumping that up, how much of that is kind of the underlying strength versus what you're seeing on the duration side?

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

Yes. George, thank you for the question. No, it's definitely the strength of the portfolio, long-term road map. I encourage everyone to watch our demonstration of the United States National Transportation Safety Board (corrected by company after the call) data archive and just the power of having Aviator or business AI integrated into information management and is helping us win now.

So it's the strength of the underlying business. These are large numbers, 63% growth in Q2, 53% in Q3. We continue to see a strong pipeline on the cloud bookings. And like I noted, I mean, the duration is longer. Average deal size was up in Q3, 30%. Contract terms are longer. We more than doubled our \$1 million wins year-over-year from 13 to 28. So it's reflective of the strength of the product. That's the underlying reason.

George Michael Kurosawa - Citigroup Inc., Research Division - Research Analyst

Got it. That makes sense. And I wanted to ask about what you're seeing from customers on AI budgeting. I think you kind of framed it in the past as kind of early spend, really being about preparing data estates so they can ultimately make the best use out of their data assets. Maybe if you could just talk about where customers are at on their journey of making those preparations and if you think about kind of the leading edge versus more the median customer.

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

Yes. As I said in my remarks, it's in every discussion. It's in every discussion, and it's real. We are -- in some customers, they are exploring vision. We have other customers piloting some of the strength of the larger, longer with ramped cloud contracts is about we get it. And so we're going to buy into the cloud bookings, but there's going to be a ramp to it over time.

No doubt, we're seeing customers consolidate and preparing for AI as well, because you don't want to go through all this spend on fragmented systems and fragmented data. So there's some prework -- we have some prework we need to do internally in some of our systems as well before we apply the higher productivity value of a language model.

So it's in every conversation. We are -- Aviator is helping us win now. You're seeing it reflected in the bookings. Pick n Pay is live on DevOps Aviator. So it's starting to move now into production.

Operator

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

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

Just first question, just on the M&A strategy. You mentioned to be more cloud oriented, but then also you remain a value buyer. Can you just elaborate on what you mean and how you bridge those two? I mean how should we think about valuations that you would consider deploying capital at versus what you typically in the past deployed it at?

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

Yes. We think the two are synergetic, right, where you -- we're going to continue, Paul, to seek value and organic growth. It's all about the future, right? I mean we have learnings in the past for sure. But the framework that the company is announcing that Madhu heavily influenced and having corp dev as part of Madhu's team, it's all future oriented. And so we're seeking cloud revenues, high recurring revenues. We're not seeking license businesses. And these are businesses -- if you think of our learnings from the past, which are interesting, but not about -- it's all about playing it forward, we're able to leverage our maintenance and our license scale of the 80 license acquisitions we did. We now have close to a \$2 billion cloud

platform, and that's the leverage going forward. Yes, we'll get the general operating synergies of acquiring a company. But we're really excited about bringing cloud companies who can leverage our operational scale in the cloud and get those synergies of growth.

And we're going to remain value oriented. I'm not here to put multiples out, right, on a call. But we're going to seek small- to medium-sized companies, value oriented that can leverage our operating discipline, our general distribution and the very large cloud operational scale. Madhu, anything you'd like to add to that?

Madhu Ranganathan - *Open Text Corporation - President, CFO & Corporate Development*

Thank you, Mark, and completely aligned. And as I said, looking forward to putting these assets in motion.

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

And expect us to close multiple transactions over the next 12 months.

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

The second question is just on like longer-term free cash flow conversion. You mentioned a couple of drivers that will help improve it. But what do you see -- like how do you rank them in terms of the most material ones that you see executing on in the near term to drive it up?

Madhu Ranganathan - *Open Text Corporation - President, CFO & Corporate Development*

Yes. I'll pick it up, Paul, and Mark can certainly chime in. Look, I think, first of all, all the -- when you get to fiscal '27, the growth in the cloud revenue at scale is going to contribute to adjusted EBITDA margin expansion. But built in there, we also think the investments we're making in the cloud, we are making predominantly in '24, also '25 will pay higher returns when we get to '27. So expect cloud gross margin without giving quantitative ranges to also improve between now and then, and that's going to help adjusted EBITDA margin.

And certainly, from a free cash flow perspective, the interest savings we are getting from delevering is going to sustain itself then. As I said, we're not taking in any interest rate improvements yet. The special charges will be slightly down, and the AMC taxes on the other side as well.

But built into all of this, I will say we make a note of and our greater scale in '27, we are going to get efficiencies through automation AI within OpenText. And Project Athena is just one example. And we are in the very early stages we are at the end of fiscal '24 in creating those plans across the company with respect to automation AI. Mark, anything to add?

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

Yes. Sure. Thank you, Madhu. Look, Paul, I'm really excited about our 3 president structure with Todd leading up our entire sales force, Paul leading up after-sales or renewals, PS and support, and Madhu taking on more operations. That is freeing my time up to focus on building a more efficient and scaled company through many things, one of which is this aspect of a technology-led business. Shannon Bell, who's joined as our -- recently, our new CDO and CIO. And I just want to double-click on the -- it's like being a new company again with AI tools and what is that next level of efficiency. We see opportunities in support of that what we're going to architect. We see opportunities in presales. We see opportunities in generated code as Madhu highlighted with Athena. We're going to have a new approach to full digital renewals.

So it's a new day of leveraging AI internally. So I just want to double-click on the other aspect to get us to our \$1.2 billion to \$1.3 billion F'27 aspirations are really leading with this technology-led business with automation, data and AI.

Operator

The next question comes from Samad Samana of Jefferies.

William Fitzsimmons - Jefferies LLC, Research Division - Equity Associate

This is Billy Fitzsimmons on for Samad from Jefferies. Last quarter, you both talked about strength in large enterprise, but maybe some potential weakness in SMB, which informed the guide. Sounds like the enterprise strength continued, but any change there quarter-over-quarter in terms of the SMB market? And then what did the 4Q guide assume in terms of macro? And obviously, it's still very early, but what did you assume around macro when putting together that initial fiscal 2025 guide?

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

Yes. Let me take the first part. Thanks for the question on SMB. Look we're expecting an SMB uptick in fiscal '25. We have Microsoft, who's obviously our largest ecosystem partner here, pushing very mid market with Azure, Dynamics and Copilot. We're also upgrading our own partner platform, really important. We've codenamed it Eldorado, and we'll be upgraded to this new platform that we built later this year that's going to allow us to bring more product to market more quickly and go across more countries now because we're primarily a U.S.-based SMB platform.

We're also seeing higher partner engagement right now, especially with Cloud Editions 24.2 and what's coming in Eldorado. We're also seeing some churn in SMB resellers. I don't want to necessarily call them out, but some of the larger ones we're seeing some churn. So we're actually excited about SMB. I know we've shouted out the last few quarters, we've had some modest headwinds. But we see it now back on an uptick starting in Q1 with the things I just outlined. Madhu, anything you want to shout out on Q4 macro?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. So on the macro side, from an externality perspective, we've certainly considered the geopolitical aspects. And as you know, we have a very global business. And look, the lower GDP growth is everywhere, and how that affects some of the customer decisions, we've really factored that in. And inflation is high, and we expect that to continue, right? And two other pieces, if you consider the interest rate environment and the FX impact, as I outlined in my commentaries, we're not assuming any benefit from the interest rate environment at this point. And also, we have a strong European business and an Asia business.

So with respect to the euro and the yen, which are the key drivers for some of that revenue, we're also not assuming improvement in those currencies. And of course if there's improvement there, our customers in those regions would also feel better about buying, but we're not assuming those benefits in our model.

William Fitzsimmons - Jefferies LLC, Research Division - Equity Associate

Super helpful. And then if I can sneak in a second question here. Mark, maybe building on some of the prior questions and answers around your Aviator investments and opportunity. Given that you highlighted that Aviator is helping OpenText win now and given what you've seen with the get your wings program, maybe you could share some anecdotes or just general feedback from early customers who have adopted or tried these solutions.

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

Yes. Very happy to. And I -- look, seeing is believing, and I encourage everyone. We posted kind of some short clips on opentext.com of applying our content cloud plus Content Aviator and Search Aviator to the U.S. National Transportation Safety Board (corrected by company after

the call) data archive. And that was the centerpiece of our demonstrations in Europe 2 weeks ago. And I encourage everyone to watch because seeing is believing. And we had thousands of people across London, Munich, Paris is literally standing-room only to watch that demonstration of applying a language model to a very rich data archive. And you can just obviously see as a knowledge worker your life on just automation and your life with automation and AI.

And what would take 3 weeks of a knowledge worker, we got down to 3 hours. And so I just -- I think seeing is believing. Go check out the video, and the demonstration was live. It's our shipping product. It's the published NTSB data and was literally just pressing a button. So look, everyone saw that, and you can see our every 90-day progress.

So Pick n Pay using a different Aviator for testing and QA, a large apparel company inspecting invoices, a large manufacturer doing contract compliance. But we think that the heart of what we're going to do and win is that knowledge worker. And just like we went from no automation to content management, to digital folders, to search, to metadata, now this is the next progression in the evolution of knowledge management to bring in a language model.

So obviously, you can hear the excitement in my voice. But seeing is believing. Go watch the demo and draw your own conclusions.

Operator

The next question comes from Adhir Kadve of Eight Capital.

Adhir Kadve - *Eight Capital, Research Division - Principal*

Great. Mark, you mentioned that a lot of your customers continue to test different use cases. Obviously, you've given some anecdotes on what customers are using right now. But in your conversations with those customers, you also mentioned that a lot of them are doing the prework to kind of really kind of full scale deploy AI. How long do you see that prework taking? And kind of where are they in that journey? And what -- and how long do you see until those full-scale deployments kind of take place?

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

Yes. Great question. One of the strengths of having a market-leading professional services organization, I mean, we have close to 2,000 billable consultants at OpenText covering every major theater in the global 10,000, is putting in place our Earn Your Wings program across that breadth.

And since our first Aviator, I think we've collected over 100 use cases, right, across all our customer interactions. So there's probably 3 categories. There are those who are going to just continue to lightly experiment and understand. There are those that are going to take a very long view. Let me consolidate, get down to one, purify my data. And then there's probably the third case, which is they're going to go now because they can see the productivity gains in very specific use cases.

So we're seeing success reflected in bookings. There's a ramp time, as we've noted. And look, I'm going to keep you updated every quarter on that progress. But I certainly would hope to see that next step-up in revenue contribution in fiscal '25, even though in our preliminary numbers, we're not factoring that in yet.

Adhir Kadve - *Eight Capital, Research Division - Principal*

Okay. Great. And of course, all the talk about cloud is great to hear. My second question will be around Micro Focus and how that plays and that product suite plays into all of your cloud growth aspirations.

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

Yes, for sure. So 3 large areas. The first is ITOM or digital operations plus their service management. And we're just very excited about a whole new set of big data, right? We've always followed big data at OpenText, whether it be contracts, whether it be employees, whether it be invoices. And ITOM or digital ops opens up a couple of big datasets for us, IT data and service data.

So we really like having that hybrid digital operations and service management as part of the portfolio. Next piece of data is the developer. And I don't think we reach our full potential. I know we don't reach our full potential unless we can open up the developer.

If you look how Oracle became Oracle, Microsoft became Microsoft, SAP became SAP, they built robust developer communities. And so not only do we have an ADM product line, but we're also going to open up the developer, thus our strategy around our trust services, our strategy around Athena, our strategy around complete developer management.

Now we're winning business at scale on very large software companies. And that's -- we're focusing the ADM organization on large-scale software developers in auto, financial services, banking, biotech, health care. So we're quite -- I'll just shout out those two as places we're very excited about.

Operator

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

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

A couple for Madhu and happy birthday, by the way.

Madhu Ranganathan - *Open Text Corporation - President, CFO & Corporate Development*

Thank you.

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

Madhu, can you remind us what your thoughts are on target leverage? So after you pay down the \$2 billion, how high or not might you take leverage up again for future M&A?

Madhu Ranganathan - *Open Text Corporation - President, CFO & Corporate Development*

Yes, absolutely. Perhaps I'll answer the question with respect to what we said on where we're targeting for M&A, right, cloud, ARR small to medium sizes, right? So being under 3 pretty imminently, I do think we will come back to around the 3-ish. Our M&A -- the capital allocation program, as you saw when primary, we refer to dividend and buybacks, but the second bucket is really the remainder, the 50% is M&A. So at the moment, I think with the \$6.5 billion of debt, our own cash flows, the strategy around the acquisitions being small to mid, I think we expect to remain around the 3x.

And the last thing I'd say is the strategy around the small-to mid-cloud M&A is about those assets contributing to growth in the future, right? That also is going to again contribute to our free cash flow target of \$1.2 billion to \$1.3 billion for fiscal '27. So again, that's how we're seeing it at this point in terms of M&A and annual leverage.

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

Great. And just a point of clarification. The transition services agreements related to AMC, is that neutral to margins?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. Yes, that is neutral to margins, I mean, at this point.

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

Okay. Great. And then finally, maybe one for Mark. Just in terms of Micro Focus, outside of the AMC business, it seems like it's stabilizing based on the 10-Q disclosure, but just commentary there in terms of how close you are to that returning to organic growth? How much work may need to be done in that regard?

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

Yes. Sounds great. Thanks, Thanos, and thanks for the question. Yes, we expect Micro Focus to return to organic growth this year. And we're also doing extremely well on the renewal side, right? Micro Focus was in the high 80s in Q3, our best rate since the acquisition, and we'll be in the high 80s again this quarter, which is great news.

And there are -- with the divestiture of the mainframe, we're now focused on the 3 big businesses, right, ITOM, which is digital operations and service management, we're focused on the developer and of course, security, right, which are the 3 big businesses there.

Operator

The next question comes from Kevin Krishnaratne of Scotiabank.

Kevin Krishnaratne - Scotiabank Global Banking and Markets, Research Division - Analyst

Just a couple of smaller ones for me. I noticed in the deck that the cloud renewal rates inched down 92% from 93%. Just wondering what happened there. And does that ramp back up in Q4?

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

Yes. Kevin, thanks for the question. I'm actually going to take that one. I just want to note that the cloud renewal rate we publish is a gross measure of cancellation only. It does not include the net impact of upsells or downsells.

Now our peers in the industry, when you look across the larger cloud companies, those are multibillion-dollar scale. They report a more like off-cloud, which includes the effect of upsells and downsells. So if we report it this way in our cloud, and we don't report that way, we would be in the high 90s in Q3. So you can expect us kicking off F'25 that we want to kind of align to the industry. This is -- it's just don't make it just a gross cancellation rate, which it is today.

You need the effects, plus or minus, of upsells and downsells. So the industry reports that way. We report that way on off-cloud like the industry does. But if we report it that way, we'd be in high 90s. So we're going to align to those new metrics starting in '25, and we'll continue to share insights along the way.

Kevin Krishnaratne - Scotiabank Global Banking and Markets, Research Division - Analyst

Okay. Good stuff. That's super helpful. And the other one that I have is just on the updated guidance for '24. When you look at the license growth and the customer support growth, they come down. I know that some of that is related to the AMC divestiture. Maybe a couple of questions. One, can you just remind us of what the mix is for AMC in terms of license versus customer support?

And then second, just looking at your -- the business excluding AMC, is there any changes there on your views on your ability to land the higher number of bookings for license revenue that typically falls in Q4? I'm just wondering if everything is sort of the status quo of what you're looking at when you were looking at Q2 versus the business today in terms of just the health of the business, excluding AMC.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. So I'll take the first one on the AMC components of revenue. We've shared this before, cloud is still very small or 0 from an AMC perspective and PS is small, so it's predominantly license and customer support.

Kevin Krishnaratne - Scotiabank Global Banking and Markets, Research Division - Analyst

Got it. Is it -- what's the mix, though, between the license and customer support?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Between license and customer support, I'm not sure we've shared that. I'm just -- so it is in our 305 filing, I believe. So you can see -- you can certainly take a look at that.

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

We can follow up offline.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. And we can actually offline. Yes. So it's predominantly license and customer support given 0 cloud and very small PS.

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

Yes. I presume that supports larger than license.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

The support would be larger than the license, yes. And I think on your second piece in terms of Q4, what are we assuming as far as the license business goes, is that your second question?

Kevin Krishnaratne - Scotiabank Global Banking and Markets, Research Division - Analyst

Correct. Yes, that's it. Yes.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. So Mark, you...

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

No. I'm sorry, go.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. So the Q4 from a license perspective, look, both Micro Focus and OpenText are behaving quite similarly, right? If you actually look at about 18 months ago when they had a completely different year-end, quarter end, et cetera, as part of integration, we've sort of synergized the compensation plan, the regional focus, all of that. So I believe we are there. So expect the general business strength and focus for our OpenText and of course, for Micro Focus now ex AMC to be quite consistent.

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

Yes. I mean the ITOM security and developer business units, are on the mother ship cadence at OpenText, right? So they're well aligned to the end of our fiscal year and will be well aligned to our kickoff July 1.

Operator

The next question comes from Stephanie Price of CIBC.

Stephanie Doris Price - CIBC Capital Markets, Research Division - Executive Director of Equity Markets Research

Happy birthday, Madhu.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Thank you, Stephanie.

Stephanie Doris Price - CIBC Capital Markets, Research Division - Executive Director of Equity Markets Research

I was hoping you could talk a little bit about the Micro Focus cost savings realization. Have there been any surprises in the process? And how should we think about and quantify the Micro integration on the fiscal '25 adjusted EBITDA margin outlook?

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. So it's actually gone very well. And it's, I would say from a supply perspective, it's gone as we expected when we did the diligence and when we formulated the plan. Now Micro Focus, as I mentioned, is very much on track, being on the OpenText operating model from an adjusted EBITDA perspective. Again, the EBITDA is impacted, obviously, by us reducing the churn and returning Micro Focus to organic growth.

But from an expense standpoint, we'll continue to optimize, to Mark's earlier comments about applying AI internally, whether it's Micro Focus or OpenText, it's one environment. But beyond that, I would say our design plan, whether we hit their facilities or the vendors or other, just the pure operating excellence, we've pretty much been very much on target.

Stephanie Doris Price - CIBC Capital Markets, Research Division - Executive Director of Equity Markets Research

Okay. And then maybe another one for you, Madhu, just on the cost of cloud services line. It seems to be ticking up here. Wondering how we should think about the puts and takes.

Madhu Ranganathan - Open Text Corporation - President, CFO & Corporate Development

Yes. Absolutely. Again, I'll speak to the cost side and certainly, Mark can chime in more from an environment and platform perspective. Look, it's really driven by the -- I mean, as we said, our second strong data point is the 53% cloud bookings growth in the third quarter. And second quarter was over 60%. If you take the prior 4 to 6 quarters, there was healthy growth, but this is a very strong second data point, and we are realizing that to continue to keep up with that momentum, and we've upped our ranges in the future as well, we do need to invest. And the investments are primarily internal cloud infrastructure investments, investments with our partners and hyperscalers.

And there is a ramp but there is a fair amount of cost. And in the past, Mark has outlined in the calls about just the growing list of compliance and certifications, including security that we have to do for our cloud business and happy to do so, but that does require a certain amount of earlier investments.

Maybe I'll add one other comment. There was an earlier question about margins in fiscal '27. These investments at scale will optimize themselves so that we have higher benefit when we look at '27, right? So these are not linear investments, they are certainly a step function investment.

Operator

I will now hand the call back over to Mr. Barrenechea for closing remarks.

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

Very good. Well, let me thank everyone for joining us today. As you can see, we're extremely excited about our cloud and AI path in front of us. And Madhu, happy birthday, and thank you all for joining us today. That ends today's call.

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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