STOCKTRADES PREMIUM COMPANY SUMMARY

OPEN TEXT

OTEX.TO

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NOTE: MAT IS LONG OTEX

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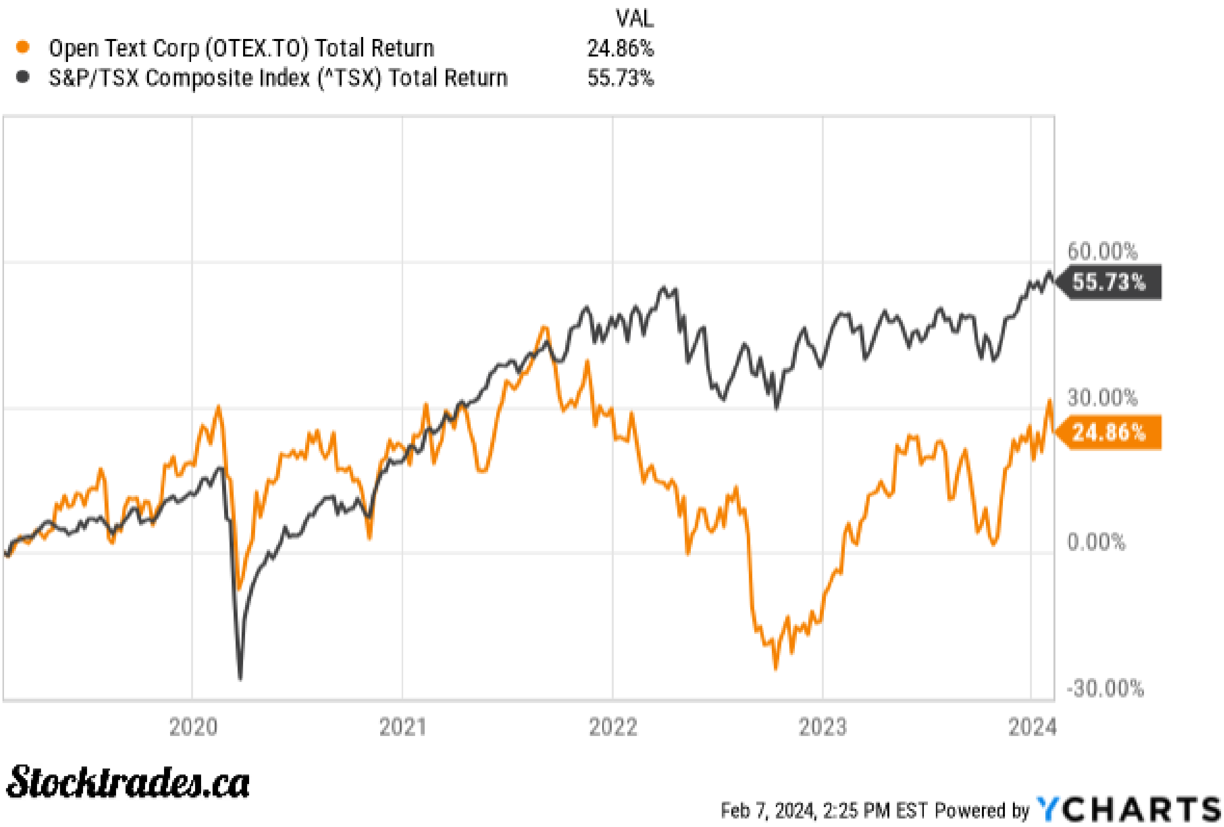

Open Text Corp grew out of a technology project involving the Oxford English Dictionary at Canada's University of Waterloo in the mid-1980s. Its software allows clients to archive, aggregate, retrieve, and search unstructured information (such as documents, e-mail, and presentations). The OpenText Information Management platform and services provide secure and scalable solutions for global enterprises, SMBs, governments, and consumers around the world. It also accelerates transformations with intelligent tools and services.

OUR GROWTH SCORE: 3.5/5

Sector: Technology

Industry: Software - Application

Current Price: $56.37

OUR DIVIDEND SAFETY SCORE: 2.3/5

Stock Type: Growth/Income

Our Risk Rating*: Moderate

1 Year Price Target: $64.52

*Our Risk Rating: Our opinion of the overall risk an investment presents. Can be shown as Defensive (DEF), Moderate (MOD), or Aggressive (AGG). By no means is this an indication of future potential gains or lower volatility.

PROS

- One of four tech Dividend Aristocrats
- Strong growth, including the dividend
- One of the cheapest stocks in the industry
- History of strong acquisitions
- 75% of the company's revenue is from recurring subscriptions
- Micro Focus is expected to generate positive organic revenue growth earlier than expected

CONS

- Risk of overpaying for acquisitions
- Lower than desired organic growth rates
- Lower starting yield
- Negative sentiment towards technology
- Market has negatively viewed the Micro Focus acquisition due to the amount of debt
- 47% of debt is variable and subject to interest rate volatility

OVERALL THESIS

With Open Text, we wanted to bring you something different. Canada's top dividend stocks are usually in the financial or utility sector, and there isn't much in the technology sector. We are big believers that investors of all kinds must have exposure to the technology index. Dividend investors don't have much choice in the tech sector, but Open Text is a solid option. Not every tech play needs to be a high-flying growth stock. We feel Open Text provides the perfect combination of both double-digit top and bottom growth rates while still delivering double-digit dividend growth. The company's two primary headwinds are the poor acquisition market and current negative sentiment. We aren't seeing serial acquirers being as successful in making deals. Why? Valuations were high, and disciplined capital allocators like Open Text would instead hold tight than overpay for acquisitions. So what does the company do if it can't find good acquisitions? It will buy back shares as it has done this past year.

Likewise, we are seeing many companies get punished after making big deals that require debt. We mentioned that the company was well positioned to make a splash, and it did when it announced the Micro Focus (MF) acquisition. However, it will need to take on debt and its debt ratio will rise from 2.0 (end of Fiscal 2022) to greater than 3.0 once the deal closes. **Update: OTEX exited Q2 with a leverage ratio of 3.7.**

POTENTIAL RISKS

The COVID-19 pandemic is not yet over, and it may continue to affect the business negatively, its operations, and financial performance. Uncertainty has led customers to be more cautious in their IT spending and deployments, which has impacted the company's organic growth prospects. As a serial acquirer, OTEX is vulnerable to overpaying for acquisitions, especially in a competitive market. The good news is that the company has remained diligent in this respect. The bad news is that the pace of acquisitions has slowed. Likewise, it could be that potential synergies from acquisitions do not materialize and, in a worst-case scenario, could negatively impact operations. You will likely see margins affected when this happens, leading to additional costs as synergies were not realized. The rise in interest rates also threatens the company's acquisition strategy. While it does have a nice cash horde, it is now much more expensive to borrow. This is one of the main reasons the entire tech industry is under pressure now. It is also why the markets reacted negatively to the company taking on $4.6B worth of debt to finance the acquisition of Micro Focus.

Beta	**0.95**
Alpha	**-6**
Our Risk Rating	**Mod***
Max Drawdown	**32.3%**

VALUATION

	TTM	5 Year Average	Industry Average
P/E	**88.73**	**39.58**	**73.23**
P/S	**1.99**	**3.59**	**5.49**
P/B	**2.82**	**2.77**	**5.78**
P/FCF	**16.01**	**13.93**	**42.27**
PEG Ratio (FWD)	**0.19**	**N/A**	**N/A**

Even though tech stocks are on the rebound, they are still down materially from highs. No company seems to be spared, even profitable companies like Open Text. The good news is that this presents an opportunity. Remember, this isn't a high-flying growth stock that was trading at wild valuations. This company is profitable and generates considerable cash flows. While the valuation gap is narrowing after a strong up trend over the past month, it still has plenty of room to move.

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To begin the year, OTEX has been relatively stable, sitting on gains of 1.2% YTD. Over the past year, OTEX has rebounded nicely off lows but is still trading at attractive valuations. At only 8.6 times forward earnings, it is trading at a discount to historical averages across nearly every metric. It has an ultra-low PEG ratio of 0.19, indicating that the markets have yet to price in expected growth rates. The markets are clearly shying away from this company due to its debt load post-Micro Focus acquisition. However, as we've discussed, the company has a plan and is executing its plan to reduce the debt load.

COMPETITOR ANALYSIS

	IBM	DAY	CSU
P/E	22.95	200.03	111.38
P/S	2.77	7.33	7.40
P/B	7.55	4.67	35.23
P/FCF	13.81	105.73	36.62

Open Text has many verticals and, as such, has a wide range of competition across these verticals. However, the company does highlight some of the main competition. First and foremost, we have International Business Machines (IBM), which it deems its primary competitor. Outside of IBM, it competes primarily with those in the information management industry. Some of the most notable competitors in that area include Veeva Systems Inc., Box Inc., and Adobe. The bottom line, it operates in a highly competitive industry with competition of all shapes and different sizes. It is why the company has been successful with its acquisition strategy – because there are plenty of smaller competitors it can pick up in the many verticals in which it operates.

DIVIDEND ANALYSIS

Annual Dividend	FCF Payout Ratio	5 Year Dividend Growth %	Dividend Growth Streak
US$1.00	37.47%	13.31%	10

The first thing that is important to note, Open Text pays the dividend in U.S. dollars. When you see Open Text's dividend charts, they can look choppy due to currency exchange. However, Open Text is among only a few Canadian Dividend Aristocrats/All-Stars in the technology sector. In Q4 of Fiscal 2023, the company raised the dividend by 3%, effectively extending its dividend growth streak to 11 years. While the low, single-digit raise is much lower than its double-digit historical average, we had warned in our previous reports that dividend growth would likely slow. Why? They are currently digesting the MicroFocus acquisition, and they will be focused on reducing their debt load. This is a prudent approach, and we welcome the news. We'd expect a return to higher dividend growth rates once the company achieves its target debt ratio, which it aims to do within the next two years. Until then, the company will likely take a more cautious approach to dividend growth.

RECENT EARNINGS

Earnings Estimates	2024	2025	2026
EPS	$4.60	$4.86	$5.19
Revenue	$5.93B	$5.94B	$6.05B
EBITDA	$2.16B	$2.23B	$2.31B
EBITDA Margin	36.41%	37.62%	38.23%

**Of note, all figures in the above chart and summary below are in USD.*

OpenText posted a strong Q2 of fiscal year 2024 that beat on the top and bottom lines. The company reported earnings per share (EPS) of $1.24, surpassing estimates of $1.19. This represents a significant increase of 31.2% compared to the same quarter of the previous year. Open Text also posted $1.535 billion in revenue, exceeding the estimated revenue of $1.492 billion. This revenue figure marks a 71% increase year-over-year, however the bulk of this growth is coming from the Micro Focus acquisition.

This impressive growth was underpinned by a substantial increase in cloud revenues, which rose to $450 million, reflecting 10% year-over-year (YoY) growth. The annual recurring revenues were particularly strong, reaching $1.146 billion, a 58% increase from the previous year and accounting for 73% of total revenues.

The integration of Micro Focus significantly contributed to the company's performance, with OpenText reporting $566 million in adjusted EBITDA. The ongoing successful integration of Micro Focus will lead to a return to organic growth for MF and align with OpenText's adjusted EBITDA margins of 36% to 38% within the fiscal year. Speaking of organic growth, it surprised to the upside as it came in at 1.2%, a noticeable improvement from Q1's drop of 0.6%.

Cloud Bookings remained strong, up 63% YoY to $236M (a quarterly record) vs previous guidance for +20% quarterly growth. As a result, OpenText effectively doubled its FY 2024 Cloud Booking guidance. It now expects 25-30% growth vs the >15% previously announced.

OpenText also reiterated long-term guidance for 2-4% organic growth and 7-9% organic cloud growth. The company's current overperformance in cloud bookings aren't likely to have a notable impact in 2024, but will position the company well to achieve long-term guidance.

The balance sheet remains robust, with a strong liquidity position of approximately $1B in cash, up from $920M last quarter. As of the second quarter of fiscal year 2024, OpenText reported a net leverage ratio of 3.7x, up slightly QoQ (3.6 in Q1). This figure reflects the company's total long-term debt in relation to EBITDA.

OpenText also committed to reducing this ratio, aiming for a net leverage ratio of less than 3x by the end of fiscal 2025 or sooner. They intend to do so by paying down $175M in debt per quarter. It should be noted that the company is divesting its Application Modernization and Connectivity (AMC) business to Rocket Software for $2.275 billion. Proceeds will be used to pay down debt, which is expected to reduce the principal outstanding to 6.9B from 8.7B today. On a pro forma basis, it will also save the company $150M in annualized interest costs. Closure is expected by the end of Q4.

Below is the company's updated FY 2024 guidance. While there were several changes, they narrowed the lower end of guidance slightly upward. As mentioned previously, the big change was in the Cloud Bookings segment.

		Updated
F'23 Reported	USD$M unless stated otherwise	F'24E in CC(2)
$528	Ent. Cloud Bookings(3) and Growth Y/Y%	25% to 30%
1.2%	Organic CC Growth(4) Y/Y%	1% to 2%
$4,485	Total Revenues	$5,850 to $5,950
32.8%	A-EBITDA Margin(5)	36% to 37%
$655	Free Cash Flows(5)(6)	$825 to $900
($132)	FX Revenues (headwind)/tailwind*	$20 to $40
	*1H F'24 FX tailwind of $42M, 2H F'24 neutral to slight headwind	
F'23		F'24E
14%	Adj Tax Rate(7)	14%
$329	Net Interest Expense and Other	$550 to $570
$124	Capital Expenditures	$140 to $160
Expect Micro Focus to return to organic growth in F'24		

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