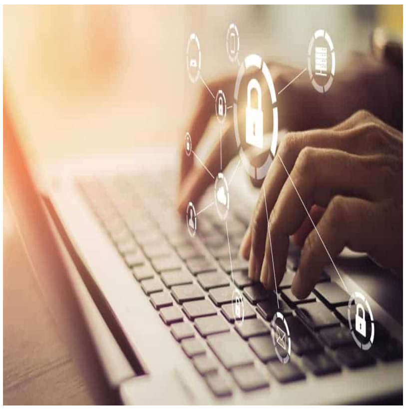

Why This Tech Stock Should Be on Your Radar

Description

Tech stocks only make up about 6% of the Canadian stock market. Consequently, great Canadian tech stocks are few and far between. **Open Text** (TSX:OTEX)(NASDAQ:OTEX) is one of those few.

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An incredible M&A strategy

As a part of its overall strategy, Open Text acquires companies strategically and generates fabulous returns on equity (ROE). Its ROE was typically in the range of 11-15% since 2010.

Thanks to the good use of capital, the stock has delivered annual total returns of about 19% since 2007. This resulted in returns that were much greater than **S&P 500's** (a proxy for the U.S. market). To put it in perspective, that's a difference of turning $10,000 into $82,684 versus $22,639!

Open Text did especially well compared to many other companies during the last recession, as its adjusted earnings per share climbed 39% and 23%, respectively, in fiscal 2008 and 2009.

The company had ample liquidity to continue with its usual strategy of acquiring companies, but it was able to do so at much cheaper multiples in the harsh economic environment.

A cash machine implies a secure, growing dividend

Open Text is simply a cash machine. In the trailing 12 months, the tech company generated nearly US$852 million of operating cash flow. Even after accounting for capital spending and dividends, the company had more than US$616 million of free cash flow. That's why management can continue with its M&A strategy whenever it finds a fitting company to buy.

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On a per-share basis, its operating cash flow generation is five times what it was in fiscal 2007. The situation is similar for its free cash flow generation. Notably, about 74% of its revenue is recurring, which implies stable cash flow generation.

Not surprisingly, Open Text's dividend per share is nine times it was when the company initiated the dividend in 2013. The company's earnings are growing north of 10%, and the company only pays out about 21% of free cash flow as dividends. So, investors can expect the tech stock to grow its dividend by more than 10% per year.

Investors should not be deterred by the stock's current small yield of about 1.6%. The company grows its profitability at a high rate that leads to fast dividend growth and stock price appreciation.

The stock began paying a yield of less than 1% in 2013, and that yield has quickly climbed to 7% for investors who have held the stock since then.

Remember that you must pay taxes on dividends, while capital gains are tax deferred. So, it's a good thing that most of the returns will come from stock price appreciation.

Foolish takeaway

As a leading enterprise information management in a growing sector and trailing 12-month revenue of less than US$2.9 billion, there's plenty of growth runway for Open Text. Investors can get double-digit dividend growth from the cash machine.

The stock had a tremendous run of 24% year to date, and it’s trading at the high end of its valuation, but it’s not exactly expensive for its growth prospects.

Occasionally, the stock experiences meaningful dips of more than 7%, at which time it would be a strong buy for investors looking for a quality tech name. Keep Open Text on your radar!

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