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CA - Q3 2013 CA, Inc. Earnings Conference Call

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OVERVIEW:

CA reported 3Q13 total revenues of \$1.2b, GAAP operating income before interest and taxes of \$370m and GAAP diluted EPS of \$0.55. Expects FY13 reported total revenues to be \$4.58-4.67b and GAAP reported diluted EPS to be \$2.00-2.08.



CORPORATE PARTICIPANTS

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Rich Beckert *CA Inc - CFO*

CONFERENCE CALL PARTICIPANTS

John DiFucci *JPMorgan Chase & Co. - Analyst*

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Walter Pritchard *Citigroup - Analyst*

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Gregg Moskowitz *Cowen and Company - Analyst*

Aaron Schwartz *Jefferies & Company - Analyst*

Matt Williams *Evercore Partners - Analyst*

Kevin Buttigieg *Longbow Research - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to CA Technologies' third-quarter 2013 earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session with instructions following at that time.

(Operator Instructions)

As a reminder, this conference is being recorded.

Now I will turn the conference over to Kelsey Doherty, SVP of Investor Relations. Please begin.

Kelsey Doherty - *CA Inc - SVP, IR*

Thank you, and good afternoon, everyone. Welcome to CA Technologies' third-quarter fiscal year 2013 earnings call. Joining me today are Mike Gregoire, our Chief Executive Officer, and Rich Beckert, our Chief Financial Officer. Welcome to the team, Mike. Mike and Rich will offer some prepared remarks and then we will open up the call for a Q&A session. These prepared comments were previously recorded, and this conference call is being broadcast on Tuesday, January 22, 2013, over the telephone and the Internet. The information shared in this call is effective as of today's date and will not be updated. All content is the property of CA Technologies and is protected by US and international copyright law and may not be reproduced or transcribed in any way without the express written consent of CA Technologies. We consider your continued participation in this call as consent to our recording.

During this call, non-GAAP financial measures will be discussed. Reconciliations to the most directly comparable GAAP financial measures are included in our earnings release, which was filed on Form 8-K earlier today, as well as in our supplemental earnings materials, all of which are available on our website at ca.com/invest. Today's discussion will include forward-looking statements subject to risks and uncertainties, and actual results could differ materially from these forward-looking statements. Please refer to our SEC filings for a detailed discussion of potential risks. Please note that our fourth-quarter quiet period begins at the close of business on March 15, 2013. Before I turn the call over, I would like to highlight that, for modeling purposes, our year-over-year currency headwind on revenue guidance is expected to be roughly 2 points for the full-year.



So with that, let me turn the call over to Mike.

Mike Gregoire - CA Inc - CEO

Thanks, Kelsey, and good afternoon, everyone. This is the beginning of my third week as CEO of CA Technologies, and it's great to be here. While our plan this afternoon is to have Rich take you through the highlights and the financial details of our December quarter, I thought I would spend a few minutes talking about why I decided to come to CA Technologies, and some of my early observations. When I evaluated taking the CEO position at CA, I analyzed whether CA had the business fundamentals necessary to be a successful company. My conclusion, and the driving force of why I accepted the CEO position, was that CA had three core business fundamentals that provide the Company with a clear advantage. First, addressable market. The total addressable market is large enough and growing fast enough to support our aspirations. It is clear that the value in the IT market is moving up the stack to management, automation and security. When I looked at CA and the size of the market it currently serves, as well as the changes to the technical landscape going forward, I think we have an opportunity to be a leader in a market that industry analysts expect to be more than \$75 billion.

Second, intellectual property. CA knows more about managing heterogeneous IT environments, applications, data and identities than any other company. We have more than 6,000 engineers on a global basis, with more than \$600 million invested in the year in organic innovation. This, when pointed in the right direction, is a formidable competitive differentiator. We have more than 700 patents, and close to another 800 under review. By the way, much of this IT is focused on where the market is going, and is of the utmost relevance. And we have key positions in markets like Mainframe, application and network performance management, identity and access management, project and portfolio and service management, as well as service virtualization. Third, distribution. To get all that technology to market, CA has a global distribution network that is difficult to replicate, and I believe can be a big differentiator for the Company. CA has relationships with the largest companies in the world. With the right focus on innovation and new markets, we can really increase our growth trajectory and our Enterprise Solutions business.

This brings me to three early observations. First, we need to accelerate our innovation curve. The markets we play in are moving very quickly. We must differentiate in everything we do. If we do not differentiate, we will become commoditized and we will not be able to grow. Profitable growth in carefully chosen markets is a clear priority for us. Second, I believe there is room for improvement in our cost of sales, our cadence for getting things done and the intensity in which we go after our objectives. We have a strong competency in selling large complex enterprise deals, but we do not move the needle quickly enough in some of the new product offerings. We need to ensure that we use our full go-to-market capabilities efficiently to gain significant market share in the key new technology domains. This is not as much about how we interface with the customer, but how we interface internally before we reach a customer. We need to be crisp in product management, product marketing and services to make sure our offerings are compelling.

Finally, we have a great balance sheet and we need to use it prudently and as a competitive differentiator by making smart investments. This will include acquisitions. But it is impossible to do smart acquisitions unless we have a handle on our innovation posture and our go-to-market model. Just buying a company for revenue and hoping we can operate it more efficiently is a low probability for value creation in today's day and age. Having known many of you in my previous role, I am sure that you are trying to calculate what all this means to our financial results. Here's what I can tell you today. Rich will reiterate guidance for the balance of fiscal 2013. And the Board of Directors and executive management team, including myself, remain committed to the capital allocation program we put in place a year ago, including the \$1 per share annual dividend. Beyond that, we are not ready to get specific. And like any new CEO, I am going to do a detailed diagnostic of where we are, compare that to where we want to be, and lay out a strategic and financial plan of how to get there. While I don't yet have all of the answers, I do have a process to challenge what we do, why we do it and the cost to get it done. At the end of the day, I want to be part of the team that wins, and to do that we need to focus on innovation and execution.

With that, I will turn the call over to Rich to provide details of the quarter and guidance. Thank you.

Rich Beckert - CA Inc - CFO

Thank you, Mike, and let me add my welcome. Before we get started with the quarter review, let me remind you that growth rates are year-over-year comparisons unless otherwise indicated. In addition, last year's third-quarter results were positively affected by our receipt of a single license payment related to a litigation settlement with a software company. This created a tough compare for our December quarter, including revenue of \$39 million reported last year in our Mainframe Solutions segment, and in the software fees and other line on the P&L. Approximately 2 points of GAAP and non-GAAP operating margins, GAAP and non-GAAP operating income of \$36 million, GAAP and non-GAAP earnings per share of \$0.05, and cash flow of \$39 million.

Moving to our December quarter results. Some Q4 renewals came in earlier than we had anticipated, with several deals closing in Q3 that we originally expected in Q4. While this timing difference has little impact on Company's annual results, it gives a tailwind during the quarter, particularly in CFFO. More importantly, the metrics around our Q3 renewals were good. Duration was down, the renewal yield came in where we would expect it; in the low 90% range. And we did a good job selling new products with these renewals, resulting in a strong attach rate slightly above our historical average. The renewal is a positive event for CA, and we look forward to these transactions as an opportunity to engage with customers and sell new products. We continue to expect FY '13 renewals to be down approximately 10% as compared to FY '12, and to grow next year. Given the shift between Q3 and Q4, we now expect our Q4 renewals to be down mid-single digits year over year.

Underlying our performance, new product and capacity sales were down just over 10% year over year, or just under 5% excluding last year's single license payment. While better than the first two quarters of fiscal 2013, sequentially we saw a large increase in the number of transactions closed with the large new enterprise customers. We still are not where we want to be. ITKO grew new product sales more than 50%. Nimssoft grew more than 80%. And Infrastructure Management grew more than 30%, driven in part by our newly introduced IM 2.0 solution. This was offset by new product sales declines in some of our large core-product categories. This is a challenge and the opportunity of a large, mature software business, managing the product lifecycle and customer relationship while driving for growth. We need to do a better job with this process and a better job of accelerating our new product sales in all of our go-to-market segments.

Total revenue for the quarter was \$1.2 billion, down 4% in constant currency and 5% as reported. This includes a \$12 million headwind for foreign exchange rates. Last year's single license payment contributed 3 points of this decline in revenue. In Mainframe Solutions, revenue was \$622 million, down 8% in constant currency and 9% as reported. Excluding the single license payment, Mainframe revenue was down 2% in constant currency and 3% as reported. Turning to Enterprise Solutions, revenue was \$476 million, flat in constant currency and as reported. Services revenue was \$97 million, down 5% in constant currency and 6% as reported. Within new product and capacity sales, Mainframe results are highly correlated to the underlying renewal portfolio. Though we had a slight increase in overall renewals this quarter, Enterprise Solution renewals were up, while Mainframe renewals were down. This contributed to a decline in just over 15% in Mainframe capacity. We also saw a decline in Mainframe new product sales of just under 50%, with approximately 40 points of this decline coming from the compare of last year's single license payment. Enterprise Solutions' new product sales were flat. New Service engagements were up 15%.

Looking at revenue backlog, current revenue backlog was \$3.5 billion, down 2% in constant currency and as reported. Total revenue backlog was \$7.5 billion, down 8% in constant currency and 7% as reported. Backlog continues to be affected by weaker first-half sales performance, as well as the headwind created by contracts burning up the balance sheet in anticipation of an increase in our 2014 renewals. From our non-GAAP perspective, non-GAAP operating income before interest and tax was \$428 million, down 9% in constant currency and 10% as reported. For the quarter, our non-GAAP operating margin was 36%. Operating margin for Mainframe was 60%. Operating margin for Enterprise Solutions was 11%. Finally, operating margin for Services was 4%. Non-GAAP diluted earnings per share was \$0.63, down 2% in constant currency to (sic-see press release - "and") 3% as reported. Excluding the single license payment, non-GAAP diluted EPS was up 7% in constant currency and 5% as reported. For the third quarter, our non-GAAP tax rate was 31% compared to 32% for the third quarter of fiscal 2012. Cash flow from continuing operations in the quarter was \$566 million, up 42% in constant currency and 43% as reported. The increase was primarily due to a \$178 million increase in cash collections, which includes an increase in single installment payments of \$150 million.

Q3 single installment payments totaled \$257 million compared to \$107 million in the prior-year period, and included a payment of more than \$100 million remitted by a customer that has typically paid up front. Total billings backlog of \$4.3 billion was down 14% in constant currency and 13% as reported. Billings backlog was affected by sales performance in the first half of the year. We ended the quarter with approximately \$1.1 billion in net cash. During the quarter, we repurchased approximately 3.4 million shares for \$75 million. We are authorized to repurchase an additional

\$579 million of common stock through fiscal 2014. Moving to third-quarter GAAP results. Third-quarter GAAP operating margin was 31%. GAAP operating income before interest and tax was \$370 million, down 10% in constant currency and as reported. GAAP diluted earnings per share was \$0.55, up 4% in constant currency and 2% as reported. Our effective GAAP tax rate for the third quarter of fiscal 2013 was 30% compared to 35% for the third quarter of fiscal 2012.

Now let me turn to guidance. While we are not providing FY '14 guidance at this time, remember that new product sales came in below our expectations this year. Given our ratable model, this will cause a headwind to revenue growth over the next 12 months. In addition, although renewals are expected to increase next year, the currently projected composition is heavily back-end weighted. Regarding guidance for FY '13, as has been our practice, guidance is based upon the exchange rate of the last day of the preceding quarter. Or for this quarter, December 31, 2012. This includes a partial hedge of operating income.

Our reaffirmed guidance is the following. Total revenue is expected to be negative 3% to negative 1% in constant currency. This translates to reported revenue of \$4.58 billion to \$4.67 billion. A point of this year-over-year decline in revenue is attributable to this single license payment. Non-GAAP diluted earnings per share growth in constant currency is expected to be in the range of 6% to 10%. This translates to reported non-GAAP diluted earnings per share of \$2.36 to \$2.44. GAAP diluted earnings per share growth in constant currency is expected to be in the range of 8% to 12%. This translates to reported GAAP diluted earnings per share of \$2 to \$2.08. Cash flow from operations in constant currency is expected to be in the range of negative 8% to negative 4%. This translates to reported cash flow from operations of \$1.39 billion to \$1.45 billion. Guidance does not include the effect of any future material acquisitions. Underlying this guidance, we expect our GAAP and non-GAAP tax rate to come in closer to the high-end of the 30% to 31% we provided at the outset of the year. At the end of the year, we expect approximately 449 million shares outstanding, and a weighted average diluted share count of approximately 457 million shares. We expect our non-GAAP operating margin to be 36% for fiscal year 2013.

And now I will turn the call back over to Kelsey and we will take your questions.

Kelsey Doherty - CA Inc - SVP, IR

Thank you, Rich. As the operator is polling for questions, I would like to inform you that CA Technologies is presenting at the Oppenheimer London Investor Conference on Wednesday, February 6; the Morgan Stanley Technology Media and Telecom Conference in San Francisco on Tuesday, February 26; and the Raymond James 34th Annual Institutional Investors Conference on Monday, March 5 in Orlando, Florida. In the interest of time, please limit yourself to two questions. ¶ Operator, please open the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

John DiFucci of JPMorgan.

John DiFucci - JPMorgan Chase & Co. - Analyst

Thank you. First of all, welcome aboard Mike. Great to see you back at the helm of an actually much larger company. But great to have you aboard. My first question is for Rich, though. Rich, when a renewal comes up, on average, do you sign a deal at the same annual rate, a lower annual rate, or a higher annual rate than the original deal or previous deal? And this would include -- I am thinking, including the renewal, any upsell or cross-sell and any price change. Now, any benefit or hit you get from those things.



And the reason why I am asking this question, as you probably know, is I get asked that a lot. And most of your business, at least for now, is tied to renewals. Given some of the things that Mike said, hopefully we will see some other sources of business. But can you answer that? And if you can give us a percent. I mean, if a renewal comes in, you sign a new deal, even with new business associated with that renewal, is it over -- is it 103%, 105%, or is it 98%? Can you give us any kind of sense of that?

Rich Beckert - CA Inc - CFO

Sure. So how are you today John?

John DiFucci - JPMorgan Chase & Co. - Analyst

Good, Rich.

Rich Beckert - CA Inc - CFO

We actually look at, as you know, multiple metrics. And the metric you are referring to is daily revenue. And if you look at it, we almost always have our transactions of daily revenue actually goes up from transaction to transaction and that is part of the metrics that we look at. So as you know, people talk about renewals. And that's only the piece that is renewing of products. We have -- when we talk about -- and in my prepared remarks, we talked about the attached rate. The attached rate is incremental new products that we put in on top of the renewal, and they almost always win when combined at a higher percent. And yes, I know the percent, John. But I will not be sharing that publicly.

John DiFucci - JPMorgan Chase & Co. - Analyst

Okay, Rich, that is really helpful though, just knowing that it's greater than 100% anyway. Because you are trading at a 4% dividend yield and a 14% trailing 12-month free cash flow yield, according to our calculations. If it's greater than 100%, then we should -- at least it has been -- then we shouldn't be worried about a secular decline here. So that's really helpful. I guess my second quick question here for Mike. Mike, I realize you have only been there a few weeks. But you still gave us some ideas on the areas you're going to be focused. Can you tell us when you might have some more granularity or more detail on how you are going to focus on those areas?

Mike Gregoire - CA Inc - CEO

You know, we do it all day, everyday. From the minute I got here, I have been going through a theme of what does a modern software company look like, and what are the things that we need to focus on? I spent four months interviewing with the Board. They were extraordinarily helpful in giving me access to the strategy department and talking to Rich to get a crisp understanding of the financials. So I felt when I got here the first day that I was prepared. And while I did have trouble finding the coffee machine, I did have an idea of the things that the Company needs to do to really brush up against this potential.

Now, I need to go challenge those assumptions with the team. And it's going to take me pretty much until the end of this quarter to do that. We've got a big conference at CA World. That's where we're going to talk a lot about products. As you know from my past, I'm a big product guy. And I really believe in strong, organic development. These are themes that I think are important to CA. And you should see us moving the Company in that direction relatively quickly.

Kelsey Doherty - CA Inc - SVP, IR

Next question, please.



Operator

Michael Turits of Raymond James.

Michael Turits - *Raymond James & Associates - Analyst*

Hi, Mike. Welcome as well. So, a similar question as far as where you might go. First of all, you come from a SaaS company and this is a Company that has some SaaS and cloud offerings. But what are your thoughts about the potential for this Company to be doing a lot more on that business model?

Mike Gregoire - *CA Inc - CEO*

That's a great question. And I also like the way that you asked it. It is not just a technology play, it's a model play. Which means it affects marketing, it affects sales, it affects services, it affects partner channel. And coming from a SaaS company, you know, we went through all of the growing pains of figuring out both models over the eight years I was at Taleo.

When I take a look at CA, they've started that evolution. But there are things that I think I can bring to the table here that will accelerate that evolution. So that we can get there faster, with stronger product, with quicker releases. And also have a customer relationship that is based upon the relationship our Company has with a SaaS company, which is somewhat different than a perpetual license company. So I think that the potential for these solutions are very appropriate as the market starts to morph from mainframes to distributed to cloud.

What I said in my prepared remarks is important. I hope everyone caught that, is, this Company has 700 patents and another 800 under review. When I did a review of what those patents are, they are the kinds of things that cloud companies need. They are based in security, application development, distributed in heterogeneous management of operating systems and applications. These patents are what is extraordinarily important. What SaaS is, is the how. So we need to not only understand how to do SaaS ourselves, but how are SaaS companies managing their infrastructure. I don't know of another company that has done as much heterogeneous data management, operating system management and security as CA.

So I am very excited by the intellectual knowledge that this Company has. And to the extent that we can put that into a platform that is cloud-based so that we can manage cloud platforms, I think that gives companies a great opportunity to manage private clouds. It gives them an opportunity to participate in public clouds. It also gives them an opportunity to integrate their heterogeneous networks that are not going to go away in the short-term. So it's a pretty exciting play from a technologist point of view. And it's also a very exciting play from a business model point of view.

Michael Turits - *Raymond James & Associates - Analyst*

Thanks, Mike, and all the best to you. Rich, if I could get a question in here. You mentioned what sounded like just a -- trying to put some parameters, some caution around expectations for fiscal '14. Should we be thinking of fiscal '14 -- given the headwind from lower new product sales in '13, should we be thinking about it as a growth year? Or as more of a neutral year, as far as sales and revenues and bookings?

Rich Beckert - *CA Inc - CFO*

Well, as you know, we're not going to give FY '14 guidance right now. But what we were trying to put color on is, clearly you have somewhat of a headwind when you look at what we have done year-to-date in the large new. And then the second part of that is, the renewals which we will have year over year will be up. They are back-half loaded, and with the ratable nature of the model, that revenue comes on in the back half of the year. Just we are just trying to give people a view there.

Kelsey Doherty - CA Inc - SVP, IR

Next question, please.

Operator

Walter Pritchard of Citigroup.

Walter Pritchard - Citigroup - Analyst

Thanks. Just to follow-up on the last one, Rich, on the back-end loaded nature of the renewal portfolio in fiscal '14. That strikes me as something new, at least in terms of what we were thinking. And I'm wondering, does that have anything to do with the way you pulled contracts into this year? And did we see some movement out of '14 into '13?

Rich Beckert - CA Inc - CFO

No, there is no -- we didn't pull any. And when we do, we will actually let you guys know when we do. Our contracts are historically always back-half loaded. The exceptions are maybe a large outsourcer or two that sometimes happen. But they usually -- the first quarter is the lightest, and the fourth quarter is always the heaviest. Next year, just the nature of it, you have even more that are more back-half than even this year. As far as this year goes, Walter, we really saw it track the way we thought. The difference is, you heard a little bit about some Q4s coming into Q3. We're not really looking to smooth things out such that -- we want it to be a good deal for both us and the customer. If we have to bring things too far forward, then we feel we don't get the right metrics that we want.

Walter Pritchard - Citigroup - Analyst

Got it. And then just on the product side. I saw the commentary on some of the larger core areas that saw declines. And I'm wondering if you could just go into more details in terms of which areas of the core business on the ES side that you saw declines there.

Rich Beckert - CA Inc - CFO

I think what we saw -- specifically, really, APM had a lighter quarter. In the first part of next year, you will see some product announcements we think will get that positive momentum, and we'll talk about those that CA World. Overall though, we actually have seen some pretty strong growth out of Nimsoft and ITKO. They have all had double-digit growth in international, across-the-board. And the other thing, you have heard us talk about the large new was slow to start. It actually had a fairly strong quarter. Not to say that one point makes a line, so I don't want people to get ahead of themselves. But we did see positive momentum in the UK, France and Germany. And so that was a positive for us.

Kelsey Doherty - CA Inc - SVP, IR

Next question, please.

Operator

Abhey Lamba of Mizuho Securities.



Abhey Lamba - *Mizuho Securities - Analyst*

Yes, thanks. Mike, welcome aboard. Now, you mentioned in your comments that you need to [execute] an innovation curve, and also [retread] commitment to the capital allocation. I know you don't want to go into too many details, but qualitatively or at a high level, how should we think about your ability to fund those invests that are needed to innovate? And culturally, as you kind of did your due diligence in CA, how well-positioned do you think is CA as an organization to execute the innovation curve?

Mike Gregoire - *CA Inc - CEO*

Two things. First of all, we spend a lot of money on engineering. And we have a lot of people doing it. So I would be reticent to want to up that in a material fashion, in any way, shape or form, until I was convinced and the management team was convinced that we are using the resources we currently spend as wisely as possible. We spend \$600 million a year on R&D. And I think that we need to make sure that that spend is done wisely, in the right areas, on the right technologies. And it's done to add value to our current customers, as well as get net new customers. So I am more focused on what we do with what we have, and making sure that that is lean, and it is innovative, and it is an area that the management team believes is also about the right size for a company with our aspirations.

Culturally, I think it is still to be determined, but my early initial view is, this is a Company that wants to play. I think that they have done a lot of acquisitions where they haven't been able to add core engineering to those acquisitions. I think that the tapestry of applications they have needs to be welded together. The concept of a platform in which to build on, especially getting into the cloud, excites a lot of the engineers in the Company. And the engineers I have met, I think they want to do innovative, creative things. So my initial impression is that we do have talent that can make that happen.

On the flip side, I don't think it is sufficient. I think we have holes in our product marketing, product strategy and product management. I am not convinced that they work as closely together as they need to, to build the kind of products that customers are looking for. Especially cloud-oriented customers. You know, cloud-oriented customers getting two to four releases of extremely high-quality code a year. We need to be able to operate at that cadence. And we need to make sure that those products do what they are supposed do all day, everyday. And when I talk to the team, they want to aspire to getting to that level of sophistication, and that level of engineering talent.

Kelsey Doherty - *CA Inc - SVP, IR*

Next question, please.

Operator

Gregg Moskowitz of Cowen.

Gregg Moskowitz - *Cowen and Company - Analyst*

Thank you. And Mike, welcome, as well. You somewhat answered this, I think, in the last question. But to ask it a bit more specifically, how would you assess CA's Enterprise Solutions technology assets and product portfolio? And also just wondering if we could potentially see some divestitures going forward, or if you are reasonably happy with the portfolio as it stands today?

Mike Gregoire - *CA Inc - CEO*

You know, I think it is too early to tell. I had my first customer meeting last night with three customers. And I'm doing a tour of offices, meeting people. Primarily sales professionals and engineers, as well as meeting customers. I'm trying to listen to how they view the Company and how they use the products. So it's a little too early to tell. But at the end of the day, we need to put products in the market that are of the highest quality and

are differentiated. And that's where this theme of innovation comes into play. I think we are at a very interesting time in the technology market segment. I think everything is up for grabs. And that means any incumbent, including us, has got to be a lot more careful and a lot more thoughtful about the products that they put into the market and how those products are going to be used.

Gregg Moskowitz - *Cowen and Company - Analyst*

Okay, that's very helpful. And then, Rich, just a follow-on on Walter's question and the fiscal '14 renewal portfolio being positive, but apparently heavily back-end loaded. Just directionally speaking, I'm just wondering whether that might indicate that the renewal portfolio is expected to be down on a year-over-year basis in the first-half? Or not necessarily?

Rich Beckert - *CA Inc - CFO*

Yes, as you know, we don't give first-half, second-half -- overall, as we said earlier, it will be up next year double-digit.

Gregg Moskowitz - *Cowen and Company - Analyst*

Okay, thank you.

Kelsey Doherty - *CA Inc - SVP, IR*

Great. Next question, please.

Operator

Aaron Schwartz of Jefferies.

Aaron Schwartz - *Jefferies & Company - Analyst*

Good afternoon, thank you. Mike, I know you touched on this a little bit. But if you looked at this opportunity -- and it sounds like from what you said, you had a lot of access to the Company before you came onboard. But do you have a predisposition to sort of run the Company one way or the other? What I'm getting at is, there have been some decisions made and a lot of work done in the background with sale segmentation, and also the capital allocation planning. I am wondering as you think about yourself as a manager, what areas would you look to really put your fingerprints on initially? It sounds like you are weighted a little bit more towards the product side, marketing side. But I just wanted to get your views on that.

Mike Gregoire - *CA Inc - CEO*

As you know, you have to get it all right. But to me, it starts with the products. If we don't get the products right, it's really hard to get the marketing right, and it's very difficult to sell if the products aren't exactly what the market needs. When I take a look at the Company, once again, it has a big spend on R&D. And I think job one is to make sure that that R&D spend is wise.

I don't think that we can do acquisitions well if we don't have our house clean in the R&D world. I don't think that we can do great organic engineering if we don't have a strategy around the products that we need and what the markets we should be in. Coupled with that, it makes it really difficult on the sales team if we are making changes all the time, not understanding who we are trying to sell to, why we are trying to sell to those particular people, and having the rest of the Company support it.



So, it isn't about one particular thing. You don't do things right some of the times, you do things right all the time. We need to do that across the board. From the minute we decide that we are going to build a product, we should know the market that we're going to be in. We should know what that product is supposed to do. And we should have the vision for the life of that product over multiple quarters.

I think we get a little too tactical sometimes, based on the product road maps I have seen and knowing the Company for several years. This is an area where I think if we get the product oriented right, the sale segmentation will follow. And you have to wrap that around the rest of the Company supporting both the products and the sales process. So I don't look at it as any one part more important than the other. My primary focus right now is in the products and in the sales.

Aaron Schwartz - *Jefferies & Company - Analyst*

Okay and --

Mike Gregoire - *CA Inc - CEO*

Is that helpful?

Aaron Schwartz - *Jefferies & Company - Analyst*

It is. And my follow-up -- and maybe it is too early for an answer on this. But something that I find myself having difficulties with sometimes and I get the question a lot, is that CA has a lot of different products in a lot of different areas. Do think there are too many products?

Mike Gregoire - *CA Inc - CEO*

I don't know the answer to that question. I've been working with the teams here and they're trying to get me up to speed. I know the ones that I've used in the past and I know the ones that are very popular. But they do have an awful lot of products. And I don't think it's fair to the teams, I don't think it's fair to the customers not to have a thorough look at each and every product, and understand how it fits within the tapestry of what CA really needs to become. Which is a very strong software Company that does great engineering and has fantastic customer relationships.

Kelsey Doherty - *CA Inc - SVP, IR*

Great. Next question, please.

Operator

[Harry Hay] of Credit Suisse.

Unidentified Participant - *Analyst*

Hi, thanks for taking the question. I'm actually calling on behalf of Phil Winslow here at Credit Suisse. I was hoping you could actually just discuss margins in the Mainframe and Distributed business. And also where do you think margins are headed in the near-, medium- and long-term?



Rich Beckert - CA Inc - CFO

Sure, this is Rich. As you know, this quarter the Mainframe margin came in at 60%. After a very difficult compare from last year. Just to remind everyone, we had a \$39 million one-time event, which most of that fell to the bottom line. There's 2 points inside of that in the Mainframe space. So, we felt that getting to 60%, that's about where we expected to be over time. We're not looking to expand those margins, as we talked in the past. There is the right kind of balance, a lot of what Mike talked about, the balance between how much you need to invest in order to keep that platform viable and how much we want to bring back in.

On the ES side, we had an 11% margin that was the -- 2 points of that, people should realize, was impacted by some severance activity. So really, we actually saw expansion in the ES margin as well, if you looked at that year over year. In the quarter, that kind of expansion we felt pretty good about. As we said earlier, we're not really going to talk about FY '14 and beyond expansion.

Unidentified Participant - - Analyst

Great, thank you.

Operator

Kirk Materne of Evercore Partners.

Matt Williams - Evercore Partners - Analyst

Hi, guys. Just, Mike, wanted to -- well, first of all, I should say this is Matt Williams in for Kirk. But, Mike, just wanted to say welcome. And most of the questions have already been answered, but I did -- maybe, Rich, maybe you could speak to this a little bit since you have been there obviously longer than Mike has. But with some of the sales changes that have gone into effect over the last 12 months or so, how is that trending? Are you starting to see some benefits from some of those changes? And, Mike, to the extent you have had a chance to really sort of dig into that, realizing that it's early. Does that seem like it is headed down the right path? Is that sort of the direction you envision that going? And I will leave it at that. Thanks.

Rich Beckert - CA Inc - CFO

Sure, this is Rich. We would say that in this quarter, the large new segment we talked about, as you know, over the last few quarters on our segmentation. We saw pretty strong growth in that segment. They said Europe had a good quarter, the strongest they've had in multiple quarters. The large new segment grew double-digit in all segments. Sequentially it did well. We are seeing Q4 and Q1 pipeline start to build. So, not to say that we are going to call victory after one quarter of success, but what we are seeing is people are getting out to see customers, going earlier in the quarter to get a transaction working.

We actually saw a closure in the early part of it, which is different than the first two quarters where we saw some transactions fall out of the quarter. We actually saw them close earlier in the quarter, which allowed us to get some more incremental business in the quarter. Of the traction is there. I think what we will see over time will really tell how much expansion we can get out of that business.

Mike Gregoire - CA Inc - CEO

To follow up from my perspective, the segmentation strategy is a wise strategy. We basically do two things. We have a name-to-based account model, which is a high-touch bespoke process for selling very complex, large transactions. We also have a lot of products that customers don't have. And we also have a lot of products we would like to sell to net new customers.

The way we go after that is under review. I think that there's opportunities to make it more effective and more efficient. And I also think that the -- in order for a sales professional to be predictably successful in our Company, we need more marketing support. We have less-than-sophisticated ways of building pipeline. We do it in a relatively expensive way. I think there are some ideas that we can bring from the SaaS world on how to do pipeline development that is a little bit more impactful. And it puts the sales professional in front of a customer that is much more prepared to buy. And our products are targeted at a customer need a little -- in a more sophisticated way.

So, I have spent a number of hours with the sales team here already, just walking through experiences and territory models, walking through experiences and pipeline development. And we are playing with a few different ideas. But I want to be careful here. The sales force here is a very talented sales force. They understand this product and they understand these customers very, very well. It would be somewhat reckless to get in the way of some of those transactions and the things that that sales team needs to do to make those transactions happen.

This is an area where I think they are pointed in the right direction. I would like to get a little bit more sophistication in the marketing and the pipeline development. And I would like to make sure that the people that are supporting the sales organization are actually supporting the sales organization. There are a lot of people in this organization that don't carry direct quota. And I would like to work with the team to find out if we can get them into quota-carrying roles, and the accountability is very clear for all of us to see. Is that helpful?

Kelsey Doherty - CA Inc - SVP, IR

I think that line is closed. Can we move to the next question, please?

Operator

Kevin Buttigieg of Longbow Research.

Kevin Buttigieg - Longbow Research - Analyst

Thank you. I will cut you some slack now, Mike, and just ask Rich a couple of questions. Rich, what were the factors, you think, driving the early renewals this period? I know that last quarter, in the second quarter, they came in lower than what you guys had been looking for. Is it an indication of a better economic environment as far as you are concerned? I know you mentioned possibly sales force restructuring. Maybe bringing some transactions to the forefront that otherwise might have been lost.

And just secondarily then, IBM reported a very large, a MIPS shipment number this period. I know your business is not directly correlated with that. But do you, or when do you expect that you might see some follow-through in terms of your mainframe capacity business?

Rich Beckert - CA Inc - CFO

Well first I will answer the first part. Two things. I do think we are doing a better job in the large new, getting out to the customers a little earlier in the cycle, and getting to the point where the negotiations start. Because they were elongated before and they were falling out of the quarter. Those negotiations happened sooner in the quarter and we actually had success. The fact, though, that for most companies it was fiscal year-end in the quarter, I think they had their own impending event as to why budget-related that they wanted to drive some of those to closure. What we did see, though, around the world was an uptick in that entire segment. So that was a positive.

As I said earlier, we saw ITKO was an example of where we had been ceding market for the last few quarters. We actually saw some customers come back around with larger transactions, which is what we had anticipated. So we're seeing good traction out of ITKO. IM 2.0, it's really now been out in the market long enough. Our reps understand that product now and you are really seeing that starting to close as well. The renewals, although we had some come in sooner -- so Q4 into Q3 -- the attach rate there was a little bit higher than the normal average, so that was also a positive.



Answering your question on the IBM mainframe. Any time they put new MIPS into the marketplace, that always benefits CA. The fact that they are putting their new box out, it helps the overall cost and price performance of the platform which we participate in. The fact that they put a lot of new MIPS out in Linux is an opportunity for us because we're really the only other vendor that goes across both mainframe and Linux. So we see that as a future opportunity as you look out over time.

We do have products that today are there. And so as more and more customers take that, that gives us upside to the Mainframe business. Although you might see that, just so people understand, those transactions will probably be recorded in the Enterprise Solutions because it is Linux. But it is the mainframe platform that will support that.

Kevin Buttigieg - *Longbow Research - Analyst*

Thank you.

Mike Gregoire - *CA Inc - CEO*

Well, in closing, first I want to thank all the employees of CA that have given me such a gracious welcome here. We had one question on culture, and I've got to tell you, this is a Company that I feel wants to play to win. And the vibe that I've had here in the last three weeks has just been absolutely fantastic. What all of our investors should expect from me and from CA is, first of all, to be thoughtful. I am not in any way, shape or form planning on doing anything that isn't thoughtful. We have a great team. The amount of data that this Company has on why they do things is astounding. There is no reason why we can't make decisions that are very data-based and very thoughtful.

I am going to be focusing on three things. Innovation. This is going to lead to an innovative Company that has the ability and the confidence to do organic growth. I just don't think that we will brush up against our potential if we don't have the confidence to bring meaningful products to the market that we build ourselves. Why when we buy companies, that we can add engineering based on our experiences in the market.

Execution. Getting the right people doing the right things at the right time at the right cost structure. This is an ongoing thing that should probably be part of our DNA. And I would like to make it part of our DNA as we continue to grow the Company. And then lastly is improving velocity. This is a Company that has an opportunity to pick up their cadence and move at a faster pace. They have the desire to do it, and they are just looking for an impetus to make that happen. And I think the management team is willing to be that impetus as we start making this Company roll out innovative products and really focusing on the customer relationships with the right cost structure.

So with that, I am going to let you go on the call here. Thank you very much for your time, and look forward to seeing you out in the field once I get up-to-speed on all things CA-related. Take care.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect. Have a wonderful day.



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