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# EDITED TRANSCRIPT

CA - Q3 2015 CA Inc Earnings Call

EVENT DATE/TIME: JANUARY 20, 2015 / 10:00PM GMT

**OVERVIEW:**

Co. reported 3Q15 revenue of $1.09b and GAAP diluted EPS of $0.49. Expects FY15 reported revenues to be $4.26-4.30b, reported GAAP diluted EPS to be $1.76-1.83 and reported non-GAAP diluted EPS to be $2.45-2.52.





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**Mike Gregoire** *CA Inc - CEO*

**Rich Beckert** *CA Inc - CFO*

## CONFERENCE CALL PARTICIPANTS

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**John DiFucci** *Jefferies & Co. - Analyst*

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## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the CA Technologies' Third-Quarter 2015 Earnings Conference Call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Jonathan Doros. Sir, you may begin.

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**Jonathan Doros** - *CA Inc - IR*

Thank you, and good afternoon, everyone. Welcome to CA Technologies' third-quarter FY15 earnings call.

Joining me today are Mike Gregoire, our Chief Executive Officer, and Rich Beckert, our Chief Financial Officer. 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 20th 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 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 risk.

Please note that our third-quarter quiet period begins at the close of business on March 13, 2015. Let me remind you that all comparisons are year-over-year and in constant currency unless otherwise indicated.

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

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**Mike Gregoire** - *CA Inc - CEO*

Good afternoon, and thank you for joining us.

During the third quarter, we saw further evidence that the strategy we put in place is beginning to yield results. While total third-quarter new sales declined approximately 10% year-over-year, this was mainly the result of a headwind from the timing of our renewal portfolio which was down in the mid-30% range year-over-year.

As a reminder, we faced a tough year-over-year comparison from a $300 million plus transaction with a system integrator that closed in the third quarter of FY14. As we have said in the past, a large percentage of our new sales are still attached to renewal opportunities.

Within enterprise solutions, we are beginning to see success in our strategy to [seed] accounts with smaller deals, prove the value our software, and expand our footprint with follow-on transactions. An impact from the smaller transaction size as near-term headwinds to the enterprise solution new sales growth.

However, while our enterprise new sales were below our expectations during the quarter, we are seeing a higher volume of transactions. Both during the quarter, and year-to-date in our growth products solutions. This is creating beachheads within our named accounts, which is leading to additional follow-on pipeline for many of these solutions.

Turning to Mainframe, our Mainframe new sales grew in the low single digits year-over-year. Their performance was driven by an increased demand for mainframe solutions that leverage the existing data and logic residing on the mainframe to develop mobile and web-based applications. Additionally, we are enhancing our current application development portfolio to address larger mainframe to mobile development market, which is providing us new opportunities to expand our footprint within our install base.

In the fourth-quarter we expect the renewal portfolio to be up in the 20% range year-over-year and total new sales to increase at least in the mid-single digits year-over-year. I am confident we are on our way to achieving our medium term goals.

Across every industry, business models are being transformed by software, specifically by interconnected applications. As software applications become the vital component of a global economic supply chain and the expectations of applications speed to market accelerate, brand loyalty can be attained or lost within seconds. This makes the quality of software development more critical today than ever.

Our solutions enable enterprises to unlock the opportunities of this application economy, where the software into the competitive differentiator and application development is the engine of innovation. We are one of the few software providers that can deliver an integrated set of solutions at scale across multiple platforms to help plan, develop, manage and secure applications. Let me provide you with more insight into the progress we're making towards our strategy to deliver differentiated solutions, improved sales execution and increased our velocity.

First, developing differentiated solutions in our three product pillars of management cloud, DevOps and security is the foundation of our strategy. In order to be a leader in the next generation of software, innovation must be the lifeblood of our company.

Over the last two years, we have dramatically improved the efficiency of our development organization. This has allowed us to redeploy resources to focus areas such as improving the user experience and the time to value of our existing solutions, as well as well as bringing new products to market.

An example of the touches upon each one of these focus areas is within our DevOps. Following the successful release of CA APM 9.7, this quarter we launched our mobile application analytics solution. This solution provides analytics into the user experience of mobile apps, and integrates with our flagship CA APM product to provide end-to-end transaction monitoring.

We are already seeing early traction with the product. As demonstrated by a win at a large US-based telco that will leverage CA mobile app analytics and CA APM to monitor transactions from tablets in its local stores, all the way back to its data center.

Over the last two years, through the hard work of the APM team, our APM business has regained momentum in the market. This is evident by our year-to-date double-digit year-over-year growth in APM new sales, and APM revenue growth returning to industry rates.

Our security group is one of the businesses driving differentiated product development. The frequency and severity of breaches we have all seen over the course of 2014 are threatening the enterprises like never before. The marketplace is looking to software firms like CA to provide new approaches to protect their users and data.

We are making investments on multiple fronts to ensure organizations can protect themselves against attacks initiated through compromised identities. One example of this is an investment in our latest release of CA advanced authentication.

Malicious hackers often use stolen or compromised identities to gain access to applications. Our latest release of CA advanced authentication uses realtime analytics, such as location and IP addresses to assess whether a user is who they claim to be. Simultaneously, it ensures that the password that the legitimate employee and customers used to gain access to corporate systems are always secure and unusable if compromised.

As we stated last quarter, we are also relocating incremental investments toward API management. API's are the next generation middleware of how customers are connecting hybrid cloud applications and infrastructure. We are the only vendor that can provide API management solutions at the scale and security levels needed for the massive amount of data traversing these newly created digital platforms.

As an example, a large consumer electronics provider chose our API management solution for its newly architected e-commerce platform. Following a failure on Cyber Monday of its previous e-commerce platform. We have the ability to triple our revenue run rate with this customer over the next 12 months with our API management solutions.

We see many other API management opportunities like this emerging in the marketplace. In addition to the development of our core product areas, we are also redeploying our investment in two adjacent capacities.

First, we are improving the integration with our current product set and with third-party providers. For example, we are tightening the integration between our application performance management and infrastructure management solutions. As software becomes the underlying supply chain of every organization, any failure in that delivery can no longer be examined independently for each specific computing layer.

Instead, the service quality must be scrutinized in the context of the entire end-to-end transaction. From the mobile interface through the application server, and back to the database on the mainframe or in the cloud. Once again, we are one of few software providers that can provide that level of end-to-end visibility and scale.

Secondly, as part of the reallocation of our software development efforts, we are focusing on what customers will need in the future. We see three disruptive forces emerging in the market that will impact software development, and we are focused on providing solutions in these areas.

The first disruptive force is the unwired enterprise. How will customers manage the complexity of the billions of IP connected devices with multiple operating systems on multiple standards which will proliferate their IT infrastructure? We have a deep history in managing network connected devices, and it's a natural extension of our capabilities to solve this emerging challenge.

This leads us to the second emerging market. As these IP connected devices create a massive amount of ambient data, both structured and unstructured, coming from new sources such as sensors and social networks. Enterprise is under tremendous pressure to securely combine their sensitive data with less risky social data and arrive at a revenue generating business outcome.

Given our expertise in managing data across multiple platforms, we are working on solutions to help manage the movement of and access to this data. And transform it into usable information that delivers a competitive advantage to our customers.

For the third emerging opportunity, API assembled applications, we already have a strong presence in core API management. We are leveraging our leadership in API management to help customers create and deploy interconnected applications, to unlock the potential of their API's and create new revenue opportunities.

In these three emerging markets, we are not making investments haphazardly or with a win at all costs mentality. We are taking a systematic approach where when we fail, we will fail early and when we win, we will have a plan in place to accelerate that product's escape velocity.

Turning now to our second major component of our strategy, I will walk you through how we are improving marketing and sales execution. We continue to improve our brand recognition in the marketplace. At CA World, our global user conference held in November, we showcased an expanding portfolio of solutions to thousands of customers and partners.

Overall, feedback from customers, prospects and the analysts noted the emergence of a new CA. With a clear focus on the challenges and opportunities faced by enterprises, and a world increasingly driven by software.

Turning to sales execution. We are continuing to see evidence that our strategy of separating platinum accounts from our named and growth accounts, as well as having sales specialized by product discipline is paying off.

As I stated earlier, while new sales in the quarter declined on a year-over-year basis, this was mainly due to a tough year-over-year compare in our renewal portfolio. We are seeing three healthy trends in our sales execution, which reinforce my confidence in the ability to grow new sales over the medium-term.

First, with our platinum accounts, our third-quarter renewal rates and attach rates were in line with historical trends. Additionally, we are seeing success with platinum reps truly partnering with our customers to understand their IT challenges.

For example, our EMEA platinum team had a service virtualization win with a large multi-national bank that is in the midst of a digital transformation. Longer term, this customer expects only 5% of banking interactions to occur in a physical location. Thus making software development crucial to their success.

The CA account team is in constant dialogue with the customer to understand how CA can help it along its digital transformation journey. This transaction marks their sixth new transaction with CA over the last 24 months, and they have increased their spending with CA over the last four years.

This second observation is, while our named and growth teams new sales performance was below plan, the volume of their transactions in our growth products grew year-over-year. As we increase the number of transactions, we are seeing a shortening of our sales cycles, as the technical aspect of the buying process has already proven.

As a result, the quality of that pipeline has improved. Let me provide a couple examples.





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First, our service virtualization solution landed a win with a Fortune 500 multi-national restaurant chain that had not bought a new product from CA in over seven years. The initial transaction was just $250,000, and is focused on a specific development project. This solution alone has the ability to expand into many additional transactions over the next 24 months.

Furthermore, this customer could have a greater than $5 million revenue run rate with us through cross sale opportunities. We have identified other accounts that have this potential.

In the second example, we forged a partnership with a leading software virtualization vendor to help build their internal DevOps strategy. They are leveraging our service virtualization solution to improve the speed at which they can develop and test against third-party SaaS applications, as well as their own internal IT services. Again, this is an initial transaction through which there is an opportunity to significantly expand our wallet share over the next year.

The final sales highlight I'll touch upon is with respect to the new renewal portfolio. In the fourth-quarter, our renewal portfolio is expected to increase in the 20% range year-over-year. As such, we are expecting at least mid-single-digit year-over-year total new sales growth.

Taking into account the tailwind from the sales opportunities related to renewals. Plus the quality of the pipelines from our named account team.

Let me now speak to velocity. In order for us to be a modern software company, we need to deliver innovation to our customers rapidly, seamlessly and predictably. This requires a culture of empowerment, where our professionals have the autonomy to drive their work forward and are held accountable for progress and results.

How we get things done is as important as what that work is. And we are highly focused on evolving our internal culture, so we can operate at or above market velocity.

On balance, in the third quarter, we made progress against achieving our medium-term goals. We are building CA with a focus on innovation, execution and speed to compete and win in one of the fastest and most exciting industries in the world. However, we are doing so with financial discipline to preserve and enhance shareholder value over the long term.

With that, I'll turn the call over to Rich to review our third-quarter financials and full-year guidance. Thank you.

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**Rich Beckert** - *CA Inc - CFO*

Thank you, Mike.

Before we get started with the quarter review, let me remind you that all comparisons are year-over-year and in constant currency unless otherwise indicated. This afternoon, I'm going to focus my comments on the key business drivers and performance indicators for the quarter. The balance of our financial details can be found in our supplemental and press release.

As many of you are aware, the dollar continues to strengthen against most major currencies. Which negatively impacts both our results and guidance.

Our Q3 revenue was $1.09 billion, and was down 1%. Mainframe was down 1%. Enterprise solutions was flat, and services declined 2%.

On an as reported basis, Q3 renewals were down in the high 30% range. But in line with our expectations. As Mike stated earlier, in Q3 FY14, we renewed our four-year system integrator transaction for over $300 million, which created a tough year-over-year compare for both renewals and new sales this quarter.

As we have previously stated, the increase and decrease year-over-year in our renewal bookings can vary on a quarterly basis. Due to the timing of large transactions.

Q3 total new product and capacity sales were down low teens as reported. This is due mainly to the headwinds from the renewal portfolio.

The renewal yield during the quarter was approximately 90%. We continue to expect FY15 renewals to be down high single digits year-over-year as compared to FY14. And flat year-over-year, excluding the large system integrator renewal that closed in Q3 of FY14. We expect Q4 renewals to be up in the 20% range year-over-year, both in constant currency and as reported.

From a geographic basis during the quarter, we saw continued improvement from our EMEA team's sales execution. As they grew year-over-year this quarter. This marks the EMEA team's third quarter in a row of performance that was in line with our expectations.

We are also seeing good performance in our Asia team. However, North America fell short of our expectations, mainly due to smaller transaction sizes. The Latin America performance was again below expectations, which we believe is mainly a result of macro related headwinds.

In our Mainframe segment, Mainframe new sales, including new product and capacity, were up low single-digit in constant currency but down slightly as reported. Mainframe new sales benefited from good capacity sales and growth in new Mainframe products. Overall, we expect our Mainframe revenue growth to be flat to down low single digits over the medium-term, which we believe is in line with the mainframe market.

Enterprise solutions new product sales were down mid-teens in constant currency, and down high teens as reported. As Mike stated, the decline in enterprise solutions' new product sales is mainly a result of headwinds from the renewal portfolio and smaller transaction sizes.

Services revenue during the quarter decreased 2%, as we previously stated. The primary driver of the decline is due to us deemphasizing non-core government services subcontracting engagements that are not directly related to our software sales.

We are refocusing on services engagements that drive new product sales. As we outlined over the last two quarters, we currently expect professional services revenue to decrease more than the total revenue during FY15 compared to FY14.

Current revenue backlog was down 2%. As I said before, consistent year-over-year growth in current revenue backlog is one of the indicators of future revenue growth. Current revenue backlog will likely grow when we demonstrate multiple quarters of new sales growth, while maintaining a low 90%s renewal rate.

Q3 non-GAAP operating margin was 38%, and GAAP operating margin was 29%. Our segment operating margins were 58% for Mainframe solutions, 14% for enterprise solutions, and 6% for services.

Our Q3 non-GAAP tax rate was 26%, and our GAAP tax rate was 29%. Q3 non-GAAP diluted earnings-per-share was $0.67, down 16% year-over-year. The decrease in our non-GAAP EPS is mainly driven by a lower non-GAAP tax rate in FY14.

GAAP diluted earnings-per-share was $0.49, flat year-over-year. Our Q3 CFFO was $313 million, single installment payments were $88 million and down year-over-year.

We ended Q3 with approximately $1.29 billion in net cash. During the third quarter, we repurchased $75 million of shares, paid $111 million in dividends, and repaid $502 million in debt.

Additionally, we have entered into an agreement to repurchase an additional $75 million in CA shares during Q4. Including the $75 million Q4 repurchase agreement, we will have repurchased $200 million in shares in FY15. We will have $800 million remaining of our original $1 billion share repurchase program at March 31, 2015.

Turning to guidance, updated guidance is based upon exchange rates on the last day of the preceding quarter which was December 31, 2014. This includes a partial hedge of operating income.

We expect currency to have a negative impact on our full-year revenue of approximately 2%, and a negative impact on our fourth-quarter revenue growth of approximately 4% at December 31st rates. Total revenue is still expected to be in the range of negative 2% to negative 1% from constant currency. This translates to reported revenue of $4.26 billion to $4.3 billion.

Non-GAAP diluted earnings-per-share growth is expected to be in the range of minus 17% to minus 14% in constant currency. An increase from our prior guidance of minus 20% to minus 18%. Mainly due to the impact from the lower tax rate.

This reflects an approximate 18% headwind from taxes based upon the 28% tax rate. This translates to reported non-GAAP diluted earnings-per-share of $2.45 to $2.52.

GAAP diluted earnings-per-share growth is expected to be in the range of minus 7% to minus 4% in constant currency, an increase from our prior guidance of minus 12% to minus 8%. This translates to reported GAAP diluted earnings-per-share of $1.76 to $1.83.

Cash flow from operations is still expected to increase 5% to 12% in constant currency. This translates to reported cash flow from operations of $1 billion to $1.07 billion. The guidance does not include the effect of any future material acquisitions.

Underlining this guidance, we expect our GAAP and non-GAAP tax rate to be 28%, which is down from our previous expectation of 30%. We still expect a full-year GAAP operating margin of 27%, and a full-year non-GAAP operating margin of 37%. At the end of the year, we expect approximately 436 million shares outstanding, and a weighted average diluted share count of approximately 440 million shares.

For modeling purposes, we would like to provide you with our initial expectation for FY16. We expect our 2016 renewal portfolio to increase compared to FY15.

Given our modest expectation for enterprise solutions and our revenue growth headwind for Mainframe solutions, we do not expect FY16 revenue to grow in constant currency. We expect a similar operating margin in FY16 as in 2015.

And now, I will turn the call back over to Jonathan and we will take your questions. Thank you.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

Raimo Lenschow, Barclays.

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**Raimo Lenschow** - *Barclays Capital - Analyst*

I have two quick questions. First one for Mike.

Mike, if you look at the 2016 guidance, the first initial thoughts about that, it doesn't look like growth returns. What makes you confident that you are on your way to achieving your medium-term goals through of a return to growth?

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**Mike Gregoire** - *CA Inc - CEO*

Sure. Great question. I'll try to be concise as I possibly can, because there's a lot of things that go into that.

But if I was to focus on just three things, first I'd go to products. If you're going to be a software Company, you have to have great innovative products. And you've if you look at what we've done over the last two years and the trajectory that we're on, we're putting some great products out into the market.

A great example of that is APM two years ago. We lost share. Just this last quarter, we're up over 20%.

And this is a great effort by our team that really put a lot of innovation into that product. Both on the user interface, the capability and lowering the cost of sales. And that's been an inspiration for all of the engineers in CA.

API management, the world is definitely moving to an API enabled world. We really think that this is going to be a software enabled economy. This is the glue that puts all of these disparate applications together.

That product is selling extraordinarily well. Where I'd put us in the top quartile of all competitors in that space.

DevOps, a lot of innovation going into DevOps. I would argue that we are the market leader in that space, really driving what you can do with virtualization in a DevOps environment.

We just launched another net new product in mobile app analytics. I think we're the only Company that can go directly from a mobile application all the way through all the middleware into the mainframe or the cloud.

And we've got a very, very strong Mainframe group. This group has done a tremendous amount of work over the last two years. They've put new innovation.

I think once again, we're one of the only companies still investing in the Mainframe. The quality of our Mainframe applications has gone up tremendously.

Last quarter, we did -- all of our releases had zero defects. Which I think was the first time in our history, and it really makes a statement to the quality we've put in place over the last couple years.

On the sales, we're in Q4. And as we're thinking about Q4 and going into 2016, I think this is the first time ever there's no structural changes going on in the sales organization. I think the restructuring that we did last year is absolutely working.

And we are we are only going to be adding fuel to that already existing structure. Not changing reporting structures and what people are working on or accounts that they're covering in a material way.

And the way I look at this is it's showing up in the numbers. Two years ago, the enterprise segment was shrinking by 20%. After one year of being here, we cut that in half.

And if you take a look at where we'll end this year, enterprise segment will be down to flat. Which puts us in a position with net new products coming out in the June timeframe, that we will be able to get this flywheel to move. And at the end of the day, it really comes down to the team.

We've put a team in place here that is really driving innovation execution and speed. They put CA first. They're very, very competitive, and they're doing it the right way which means doing the right thing.

So when I put all that stuff together, it gives me confidence that we're definitely on the right path. And when I look at the numbers and the trajectory of the things that I'm paying important to, are we innovating new products, is ESTG growing? Is the mainframe a stable component of our ecosystem?

It gives me confidence that we're on the right track. A long answer, but thank you for a great question.

**Raimo Lenschow** - *Barclays Capital - Analyst*

Perfect. That was very comprehensive, and that helps us a lot actually. And the second question I had was for Rich.

Rich, if you look at the cash flow this quarter, it was probably a touch light what we modeled. I think consensus was a little bit all over the place on that number.

But it still requires to make the full-year numbers a nice uplift in Q4. Can you talk a little bit about the drivers there and your confidence level? Thank you.

**Rich Beckert** - *CA Inc - CFO*

Sure. So we feel we're very much on track for our guidance of 5% to 12% in constant currency.

I want to remind you from my prepared remarks, we have a larger install collections. It was $251 million in Q3 last year, and it's only $88 million. So, single installments were really the single biggest driver, $162 million. And the last part, just want to remind people that we are still paying off the remainder of our restructuring rebalancing payment which ends at the end of this year.

**Raimo Lenschow** - *Barclays Capital - Analyst*

Perfect. Thank you.

**Operator**

John DiFucci, Jefferies.

**John DiFucci** - *Jefferies & Co. - Analyst*

Just two questions, I guess. If new sales are tied to renewals and the fourth-quarter renewal portfolio is up 20% year-over-year, why do you expect the fourth-quarter new sales to be only up at least mid-single digits year-over-year?

**Rich Beckert** - *CA Inc - CFO*

John, this is Rich. So what we said is it's at least high single digits. We think with the look of the mix of what we have in our portfolio and what's coming due, there are some transactions in there that will be mainly renewal and not necessarily the same percentage.

What we have seen year-to-date is, and especially in Q3, was a very strong attach rate. So we don't see any anomalies as to our attach rate. When we have renewals, we're executing [these] just as we had planned.

**John DiFucci** - *Jefferies & Co. - Analyst*

Okay, Rich. And did you say high single digits or mid-single digits?

**Rich Beckert** - *CA Inc - CFO*

Mid.

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**John DiFucci** - *Jefferies & Co. - Analyst*

Mid, okay. And then I guess this is just -- a lot of ways to ask this question and it's along the same lines, guys. But we're hearing -- when we talk to people in the field, we're actually hearing more excitement around CA products than we've heard in a really long time, which is really interesting.

But if the 2016 renewal portfolio is up over 2015 and new business is tied to renewals, and again, with this excitement we're hearing about. Why would revenue be down on a constant currency basis in 2016?

Rich, is there some kind of -- is there something accounting that I'm not thinking about? I realize it's a subscription model, but am I missing something?

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**Rich Beckert** - *CA Inc - CFO*

Right. It's a good question. So the so the way to think about it, if you look at our segments, you will see that our [ES] segment is slowly building. And this is the first quarter in a while where we actually got to zero. You'll actually see as we progress through the rest of the year, in order to make full-year guidance, you can imagine that actually gets positive.

But as we go through, we still have the Mainframe business which you see this quarter came back to a minus 1. We think that, as we said earlier, that's still going to be minus 1, minus 2%, maybe flat over time. So we need that mix to overtake the Mainframe decline in order for us to do, on a consistent basis, say we're going to be in positive revenue growth.

Remember, in May, we'll be giving you guys full guidance. What we were trying to do is to get people to understand the headlights that we see as of right now. Clearly the mix of how we do that business (inaudible) will impact the amount that gets reported in Q4 versus FY16.

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**John DiFucci** - *Jefferies & Co. - Analyst*

Okay. So we need to see traction in the ES business to overtake the bigger mass of the Mainframe business. Which, with the mainframe flat, then that's fine, but it could be down a little bit which okay. I get it. Thank you.

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**Rich Beckert** - *CA Inc - CFO*

You're welcome.

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**Operator**

Walter Pritchard, Citi.

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**Walter Pritchard** - *Citigroup - Analyst*

Just a follow-up question on similar topics here. On the North America side, it sounds like the macro seems relatively strong in North America. And you saw some changes to the sales trends there with smaller deal sizes cited.

Could you talk about whether or not you think that's something that you've caused on your end was anything around sales execution? Or is there something happening in the market that's impacting that? And what are the prospects of that improving as we move into Q4 and into 2016?

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**Mike Gregoire** - *CA Inc - CEO*

Walter, it's Mike.

I'm encouraged by the number of at-bats we're getting. And it goes to John DiFucci's comment, where people are looking at CA a little bit differently, which means we're getting into more sales cycles. As we're getting to these sales cycles, I don't think it's different for anybody.

The technical buyer wants to try and buy. And if they have an opportunity to do what I call a mezzanine transaction, get it in, make sure it works. They usually do that now before they go for the big transaction.

I think you have to be very careful to be an elephant hunter these days. That's how you get really awkward and jumpy bookings quarter-to-quarter.

What we've been training our sales force to do is get in there. We're very confident in our products. We're more than happy to do try and buy, we're more than happy to do a proof of concept.

And in the end, we think if you take a look at it over a 12 to 18 month timeframe, we think it's going to shorten sales cycles rather than elongate them. Having a very long sales cycle for a very large transaction compared to having 8 to 10 transactions going on at the same time, where the customer sees the true value of the product.

We just think that's the way the industry is moving, and you're seeing some of that transition happen. It's been happening all year long.

So I don't see anything systemic. I like the North American market. I think we feel very good about security. That portfolio is very competitive, and we see a lot of need for security.

I love what we're doing in DevOps. Because I think as customers start building applications, especially custom applications for mobile, I think we're very well-positioned for that. And then when you take a look at our management cloud, everybody wants to understand where these transactions are.

Is it the network that's down? Is it the application that's down? Is it the hardware that's down?

We're one of the few companies that can monitor that at scale across multi-platform. So, I feel pretty good about those problems being solved in North America.

Europe was very strong. Once again, three quarters in a row Europe has been very strong. We definitely over performed in Asia this quarter, so I was very happy with that.

The big area that we were a little bit surprised about is how poorly Latin America did for this last quarter. And we're taking a look at that from an economic perspective, as well as from an execution perspective.

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**Walter Pritchard** - *Citigroup - Analyst*

And then, Mike, one thing you've talked about in the past is unattached new product sales. Sales that are happening outside the renewal. And understanding that's still a smaller portion of your new business, but what can you tell us about what you saw in that type of business in the third quarter in the pipeline for the fourth quarter?

**Rich Beckert** - *CA Inc - CFO*

So this is Rich. So what we really saw, and Mike just touched on it, if you'll look at the named and growth accounts. We saw higher volume than previous year, but the actual transaction size was smaller. And those are all coming outside of the renewal cycle.

If you look at our platinum accounts, those are the ones that have a much higher attach rate and are much tighter to the actual contract renewal date. And so, in North America, you had a lighter contract for the platinum, but we saw in service virtualization as an example. It was a smaller deal size but more volume, and that's really the land and expand model that we're asking those guys to perform.

**Walter Pritchard** - *Citigroup - Analyst*

Great. Thank you.

**Operator**

Daniel Ives, FBR Capital Markets.

**Daniel Ives** - *FBR Capital Markets - Analyst*

I was on John's first welcome back call. I was waiting for a five-point question, so I'm disappointed.

So as you've gone through your kickoffs and sales things, what do you think the biggest challenge and opportunity is on the other end for the next year as we look out?

**Mike Gregoire** - *CA Inc - CEO*

I think the biggest challenge is driving towards this notion that customers want to try and buy before they do large transactions. As an enterprise software Company, that's a bit of a change in skill set. We've been working on that over the last couple years.

But if you take a look at the way all of our marketing programs run, all of our lead generation programs run, how our sales compensation works. How we're allocating resources, it's really driving at getting the software in the hands of the people that are going to use it, so they can see the value and then come in for to the larger purchase. So I think that that's a systemic challenge that all software companies have to deal with.

I think we recognized this two years ago, and started working our way towards it. But I wouldn't declare victory on it as of yet.

Secondly, is it comes down to net new product innovation. This market is changing so quickly, customers are so demanding that you have to have your innovation thinking cap on. And you have to imagine the problems that customers are going to have one to two years out.

Because it takes an enterprise company to build software at scale, at least a year to get it through the development process, through the testing process to make sure that it works as promised and at scale. And so, that's something that we're constantly, constantly thinking about. And I think we are in much, much better shape to accomplish that mission today than we were a year ago.

**Daniel Ives** - *FBR Capital Markets - Analyst*

That was really insightful. Thanks.

**Operator**

Matt Hedberg, RBC Capital Markets.

**Matthew Hedberg** - *RBC Capital Markets - Analyst*

Mike, you called out in your prepared remarks security obviously remains in the headlines almost daily. And your identity and access management products really should see a benefit.

I'm curious, how do customers look at security solutions from CA versus more pure plays? And are you seeing a higher attach rate on some of these security solutions?

**Mike Gregoire** - *CA Inc - CEO*

I think we -- first of all, we're considered to be a very top-tier vendor. But the differentiator for us is the scale and multi-platform. When you think about all the security problems that are happening, especially in identity and access management, you do not want to have security happen in just one geographic location or with just one application.

And as companies are starting to have API enabled applications, which is one application talking to another, they need something absolutely super secure. To make sure that not only that that person is who they say they are, that machine is who they say they are. And I'd put us in the upper quadrant of any company that can handle that with sophistication and scale, and that's the area where we're really, really driving home the differentiation of CA.

**Matthew Hedberg** - *RBC Capital Markets - Analyst*

Thanks. And then, Rich, enterprise markets, I believe they were 14% in the quarter. Can you remind us again where those are going to go longer-term? And second, should we expect a sequential decline there into fourth-quarter similar to the last few years?

**Rich Beckert** - *CA Inc - CFO*

Right. That's a good question.

If you look through the first three quarters of last year, you'll see that we are running ahead of where we said we would come in. And so you can see this year has a similar pattern to it. So we're very comfortable with that 37% margin that were talked about earlier on guidance.

If you think about the ES segment, you can see that building over time. But, yes, there's a lot of things that will be allocated back to the ES segment. An example would be sales, marketing, things of that nature, procurement.

And so you'll see that dip in the fourth quarter. As we move out over time, what we told people before, is we expect that to grow into the teens.

**Matthew Hedberg** - *RBC Capital Markets - Analyst*

Great. Thanks a lot, guys.

**Operator**

Matt Williams, Evercore.

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**Matt Williams** - *Evercore Partners - Analyst*

Obviously, calling in for Kirk. Just two from us. Number one, in terms of the smaller deal sizes and enterprise, especially North America, was there any particular product segment that this trend impacted, or was it across the board from a product portfolio standpoint?

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**Mike Gregoire** - *CA Inc - CEO*

I think it was pretty much across the board for any of the growth products. So when you're taking a look at our API management, you're taking a look at service virtualization, those types of products. Those -- all of the higher growth products exhibited that kind of feel.

We also had some smaller deals happen in the mid-market, in the unified infrastructure management, which is exactly what we've been pushing for. We used to only sell that product and that suite of products to some of the biggest customers in the world.

The fact that a couple billion dollar companies are starting to use that product and understand it, and that that product comes from a very sophisticated try and buy platform with unified infrastructure management, Snap. I think is, once again, these are the confidence builders that you want to see because this is how a modern software company goes to market.

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**Matt Williams** - *Evercore Partners - Analyst*

And maybe as a follow-up to that. It sounds like you're seeing more and more of these smaller upfront deals with the payoff being that the customer circles back and re-ups down the road. Is the pace at which customers are coming back to you to expand their initial deployments, is that accelerating at all relative to what you saw 6 or 12 months ago?

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**Mike Gregoire** - *CA Inc - CEO*

I think the data is too jumpy right now. I don't think our pattern recognition is great.

I think we see, in Q2 for example, accelerated faster than I thought it would be. Then in Q3, it didn't accelerate as fast as I thought it would be. So I think it's going to take us a little bit of time to get the pattern recognition and a body of transactions where we have a feel for how this works quarter in and quarter out.

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**Matt Williams** - *Evercore Partners - Analyst*

Great. Thanks for taking the questions.

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**Operator**

Philip Winslow, Credit Suisse.

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**Philip Winslow** - *Credit Suisse - Analyst*

I just have a question on the Mainframe side. Wondering if you could just comment on the pricing environment that you've seen there, and maybe compare that to the past couple quarters past couple years?

And then also, just as you look forward on the Mainframe side, how you're thinking about that segment especially with the new z launch out of IBM? Just any sort of color there, that would be great.

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**Mike Gregoire** - *CA Inc - CEO*

Well two things, and I'm going to get Rich to weigh in on it as well.

From a pricing perspective, we see a lot of stability and there is a differentiation. I think customers are getting very careful about mainframe purchases, especially maintenance. If you can't show in a maintenance cycle that you've actually put some real sweat equity into adding value to existing code, I think you're getting a tremendous amount of pushback from customers.

So that's why, in my opening remarks, I talked about the Mainframe and I haven't let them off the hook in any way, shape or form on innovation. And every new release has got to have something in there that is better than the previous release. Whether it be user interface, the amount of mips it uses, whether it's the ease-of-use of that application, or just net new SKUs coupled with features that have been on the blocks for a while with respect to customers.

So I think if you do that, we've seen a lot of stability in our maintenance pricing, And I think our customer satisfaction this last quarter was the highest in the history of CA. So I like the imagery of that. I like I like the feel of that business.

Now I do think we have some more opportunity with what's going on with the announcement of the new z system coming from IBM. IBM, we participate in a relationship with them in three ways.

They are a great Partner for us in the systems integrator side. They are a great Partner for us with respect to the hardware side.

They share a lot of information with us on what they're doing with their product road map. They want that platform to be as powerful as possible, and they encourage companies like CA to write software for that platform. And then of course, we do get out on the software side.

So when I take a look at the whole relationship and I take a look at their investment, I think they spent $1 billion over the last five years, I think that's net good for us. Because at the end of the day, customers are going to want to have a choice.

There are certain customer segments that really like dealing with CA, and they could have picked any vendor they wanted to on the mainframe. They've standardized on us, and they want us to invest. And I think that that's the fact that IBM has made that platform once again relevant, I think is a good showing for us in our Mainframe segment.

Now, Rich spends a lot of time on pricing and a lot of the maintenance contracts. Maybe you can give some contextual information, Rich.

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**Rich Beckert** - *CA Inc - CFO*

So I would say, we had a strong new Mainframe sales with low single-digit growth. And that's important, because as we talked about earlier, we had a lighter renewal portfolio. So to have single-digit growth on a lighter renewal portfolio is a pretty strong statement of the platform.

And then I'd also say, we saw a good attach rate and we had a 90% plus like normal on the renewal yield. So that says we're not trading off our maintenance stream for that incremental sales.

As far as the z box, I think that will really benefit us over time. It helps the entire ecosystem, as Mike said, with the total cost to computing driving that down. The fact that z Linux will play a bigger and bigger part of that, we have a lot of products on the distributive side that participate. And we're really the only vendor with IBM that have a strong Linux and strong Mainframe.

And if you read a lot of their prepared remarks, that is becoming a bigger and bigger place for people to consolidate their Linux farms back onto the mainframe. And that plays right into our sweet spot.

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**Operator**

Michael Turits, Raymond James.

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**Michael Turits** - *Raymond James & Associates, Inc. - Analyst*

Back to the revenue guide for next year. The street was at flat on a nominal basis, obviously we had some currency headwinds.

So do you think -- did the street just get ahead -- did we just get ahead of ourselves on that? Or is there anything that actually diminished in terms of your outlook for when you start to inflect up towards growth?

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**Rich Beckert** - *CA Inc - CFO*

Well, as we talked about all the time, Michael, the revenue backlog, especially the constant line, is really the best indicator for next year. And where we currently sit at a minus [2%] in constant currency, we think at this point in time it's prudent to tell you that we're closer to the flatter end of that than to start to see the growth.

As I think John had asked a question earlier though, Q4 is always an important and big quarter for us. How that booking is recorded, either ratable over time or a little more upfront, will start to push that. And again, what we're talking about the difference here is maybe $30 million as to whether or not which direction you're going to really land.

So what we were trying to indicate for people was just headlights. We'll come out with the proper guidance for next year in May, but we didn't want people to get too far ahead.

Because as you can see, in order for us to get on track with our guidance, you'll see a fairly strong Q4 from that revenue standpoint. And we wanted to make sure people understood, over time, you really still need to make sure you're looking at that revenue backlog.

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**Operator**

Abhey Lamba, Mizuho Securities.

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**Abhey Lamba** - *Mizuho Securities Co., Ltd. - Analyst*

Thanks for some color on the Mainframe market. I just want to dig into that a little bit more.

You're calling for your revenue performance to be in line with market, but there's clearly disruption at some of the smaller players in the space. So is there any opportunity for you to gain shares worth of them?

Are there any other structural headwinds in the market that you're seeing which could negate that and get you back to the market growth rates? Or is there opportunity for you to do better than that?

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**Mike Gregoire** - *CA Inc - CEO*

It's always difficult to get somebody to switch platforms of any size. If you're a small player and you're moving off the mainframe, we're not trying to keep you on the mainframe. We're trying to get you into our distributed products, if you've made that architectural decision that that's where you want to go.

If you are a large mainframe user, we're trying to get you to use as many of our products, whether it be on the enterprise side, or on the mainframe side. But we don't go out and target, at this point in time, competitive replacements, of large-scale mainframe applications. The cost of sale is just super prohibitive.

It's more important for us to leverage that mainframe relationship to increase the capacity usage, add net new product, and really drive into the distributed side of the house, the ESTG side of the house. And that's worked out really well for especially the larger mainframe clients. I can't think of any of our top 100 customers that have we have a mainframe relationship with that we don't have a significant distributed relationship with.

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**Rich Beckert** - *CA Inc - CFO*

Can I just add one thing to that? I think when you look at our level of investment outpaces a lot of the smaller vendors. So as they come out with their newest box, what you really start to see is our ability to exploit that over the next year or so. And that does make people decide whether or not they want to switch off of some of these single product companies over to us.

So I do think every time there's new technology, as I said earlier, that allows you to run a z and Linux and we're one of the few guys that can do that. It gives us a leg up when we go back in for our renewal versus a competitor's renewal.

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**Operator**

Gregg Moskowitz, Cowen and Company.

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**Gregg Moskowitz** - *Cowen and Company - Analyst*

First question is, despite historical issues in Europe as you noted earlier, your sales execution grew year-over-year. And it's the third consecutive quarter of in-line performance. Mike, do you think you've turned the corner in Europe?

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**Mike Gregoire** - *CA Inc - CEO*

I think we always use the word Europe as one amorphous homogeneous idea. Europe is not one thing. I think you have to take a look at Europe in its piece parts.

I like what's happening in the UK, and I absolutely think we've turned the corner there. I really like what is going on in -- of central Europe. We had a very good showing in France this quarter. I think that there's some interesting things going on there.

Germany is an area where we need to invest. I think that our ability to perform in Germany needs to be shored up. I think that that's a very large market, and we are definitely not even getting close to our fair share in that market.

And then when you take a look at Spain, Portugal and those areas, they're tougher markets for not just us, but for all of us. So when I take a look at Europe in totality, I think we're executing better in each and every market, but some markets are just better than others. Very encouraged once again by the UK.

I want to do more in Germany. I think that that needs to be part of our strategy in 2016. And we are definitely one of the top players in the Nordics, but it's also a relatively small market.

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**Operator**

Mark Moerdler, Bernstein.

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**Mark Moerdler** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Two quick questions. The first one is, given the deal size change that you've had or the -- a large number of these smaller deals, what is the contract term on them? Are they a much shorter contract term, or a one-year contract term that's associated with it?

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**Mike Gregoire** - *CA Inc - CEO*

Mark, there are traditional three-year terms.

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**Mark Moerdler** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. So it's not affecting in any way the revenue recognition, it's just smaller ones that you build upon?

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**Mike Gregoire** - *CA Inc - CEO*

Correct.

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**Mark Moerdler** - *Sanford C. Bernstein & Company, Inc. - Analyst*

Okay. And the second one is FX. FX seems to have hit you on both sides, on the income and cost side. How do you see that netting out in the earnings, impact on earnings?

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**Rich Beckert** - *CA Inc - CFO*

So as we stated earlier, we do have an impact in the quarter. The revenue was minus 2% -- and it's going to be 4% in Q4. So full-year, down a little over a point and a half.

So it definitely has that draw downward. From an EPS, it was minus $0.02 in Q3, but it will be a benefit in Q4. And the reason for the benefit in Q4 is, a lot of what we have already done with the treasury team actually times out at the end of the year. So it has much less of a flattening effect on EPS for the full year.

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**Operator**

Thank you. And at this at this time, I'd like to turn the call back to management for closing comments.

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**Mike Gregoire** - *CA Inc - CEO*

Thank you very much, and thank you, everyone, for being on the call. I know everyone is super busy. I really appreciated all the questions.

I think your big takeaways from this call should be that it is not lost on this management team that there's still a lot of work to do. But we do have a team in place that can do the work, and do it in a thoughtful way. We are clearly on a journey, and most journeys are not straight lines.

But if you take a look at what's happened over the last eight quarters, just about every metric we measure is moving up and to the right. We are never going to be happy with the pace that that happens at. We're always going to want to go faster.

But our focus on innovation, execution, and constantly increasing the speed at which this Company operates I think is going to put us to where we really want to get to. Which is somewhere in the mid-single digits growth, with a high 30%s operating margin. And I feel pretty confident that we're well on our way to make that happen.

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**Operator**

Thank you. Ladies and gentlemen, thank you for participating in today's conference.

This does conclude today's program. You may all disconnect. Everyone, have a wonderful day.

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