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CA - Q1 2017 CA Inc Earnings Call

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OVERVIEW:

Co. reported 1Q17 total revenues of \$999m and GAAP diluted EPS of \$0.47. Expects FY17 reported revenues to be \$4.03-4.07b and reported GAAP EPS to be \$1.88-1.93.



CORPORATE PARTICIPANTS

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Mike Gregoire *CA Technologies - CEO*

Rich Beckert *CA Technologies - CFO*

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PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the first quarter 2017 CA Technologies earnings conference call.

(Operator Instructions)

I would now like to introduce your host for today's conference, Ms. Traci Tsuchiguchi, Vice President of Investor Relations. Please go ahead, ma'am.

Traci Tsuchiguchi - CA Technologies - VP of IR

Thank you and good afternoon, everyone. Welcome to CA Technologies' first quarter 2017 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 Wednesday, July 27 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 second quarter quiet period begins at the close of business on September 15, 2016. 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.

Mike Gregoire - CA Technologies - CEO

Good afternoon and thank you for joining us. Following our solid performance in FY16, I am pleased to report that we are off to a strong start in FY17. Our Q1 revenue grew year-over-year for the second consecutive quarter. Revenue improvement was broad-based with growth across all geographies. Our Q1 results give us improved confidence in our ability to cross over into modest growth for the full year in 2017.

As you read in the press release, Rich Beckert is retiring after a decade of service to the Company. Rich joined CA in 2006 and has played an important role in CA's evolution. I'd like to thank Rich for his many contributions over the years. He has been instrumental in implementing processes and instilling discipline that have helped lay the foundation upon which the Company can grow.

While we undertake a search for Rich's replacement, Kieran McGrath, CA's Corporate Controller, has been named interim CFO, reporting to me. Kieran was the Finance lead of IBM's \$25 billion Global Software Business and brings a wealth of financial and operational and transformational management experience.

We also announced that Adam Elster and Ayman Sayed have been named President, Global Field Operations and President, Chief Product Officer, respectively. This fine-tuning of our organizational structure further strengthens and integrates Sales and Product, two areas that are key to our growth. This level of collaboration insures that our development and go-to-market efforts are completely in aligned to customer and market demand.

Turning to the quarter, new sales were up significantly higher than we had expected. Total new sales increased more than 50% and organic new sales increased in the high 20s. A big driver of Q1 new sales growth was a transaction with a large system integrator, or SI, that was originally slated to expire in FY18. We are pleased with the metrics of this seven-year deal which had a healthy attach rate and enabled CA to gain wallet share. Excluding this early renewal, total new sales increased in the high single digits year-over-year. New sales in the quarter also benefited from deals that slipped from Q4 last year into Q1 this year.

Mainframe new sales increased well over 100% year-over-year. Enterprise Solutions new sales increased in the low 20s year-over-year. From a product perspective, the greatest contributors to new sales growth in the first quarter were Mainframe, Security, Agile Central, PPM, UIM and APM.

Overall, I am very happy with our first quarter results. Our revenue grew nearly 3%. We delivered very good margin performance, despite a difficult year-over-year compare which drove solid EPS and CFFO.

Looking ahead to Q2, please remember that Q2 of FY16 included a large SI renewal with incredibly strong metrics, which creates a very difficult compare next quarter.

Turning to our products, Q2 marks the anniversary of our acquisitions of Rally and Xceedium. Both acquisitions continue to perform well and their performance has accelerated beyond pre-acquisition run rates. That said, there is still ample runway ahead for each of these acquisitions to reach their full potential.

In the quarter, as part of the large SI deal, CA Privileged Access Management, or PAM, closed the single largest deal in Xceedium's history both pre- and post-acquisition. It was selected over other competitors to become the standard for the large SI to leverage across its more than 1,000 global customers.

Separately, CA PAM displaced an incumbent at a large American multi-national telecommunications company due to CA PAM's strength in password management. Our performance this quarter demonstrates our strategy of acquiring great technology and leveraging our relationships to accelerate growth. This is one of the reasons why we are committed to M&A as part of our three-legged capital allocation strategy. Clearly, we are very happy with our recent acquisitions.

Meanwhile, we remain committed to cultivating the spirit of innovation at CA. Unified Infrastructure Management, or UIM, for Cloud, launched at the end of the quarter. It is a great example of how we're executing to our strategic imperative to innovate organically. UIM is a market-leading cloud-monitoring solution that showcases CA's position as a platform agnostic solution provider. With our new UIM for Cloud release, CA now supports Amazon Web Services, OpenStack, Docker, Nutanix, and PureStorage for private and public cloud, as well as on-premise.

Many of our customers see CA Unified Infrastructure Management at the heart of their cloud strategy. Our new capabilities supporting Amazon Web Services and OpenStack are essential in helping to optimize customer workloads. We are pleased that IT Central Station, a leading crowd-sourced product review site for enterprise technology, named CA UIM as the number one solution for cloud monitoring.

Project and Portfolio Management, or PPM, is another area that has consistently been a bright spot and serves as a great example of our organic innovation. PPM had a good first quarter, with new sales up mid-single digits year-over-year. In the quarter, there were a number of six figure transactions that closed, three of which were brand new customers to the platform.

We often win because of PPM's superior functionality, which is encouraging and highlights the value our internal development teams can bring to market. PPM new sales have grown in four of the five most recent quarters. We are pleased that in our first quarter CA was named a leader in the Gartner Magic Quadrant for IT Project and Portfolio Management Software Applications.

I'd also like to take the opportunity to call out the exceptional quarter Mainframe had in Q1. I am very pleased with both Mainframe new sales and revenue performance in the quarter. As one of the few software solution providers investing in the Mainframe, CA is a trusted partner to many of the largest enterprises around the world.

One of our key competitive advantages at our largest customers is our combined Enterprise and Mainframe solutions portfolio. Our customers are challenged to manage increasingly complex heterogeneous public, private, hybrid-cloud and on-premise environments. Our combined Enterprise and Mainframe Solutions segment enable us to strategically partner with customers to develop innovative solutions that solve some of the most complicated problems that span multiple platforms.

Many of our customers benefit from the ability of CA to manage their entire infrastructure stack across distributed, cloud and mainframe. The positive impact this has on our customer is notable. It lowers our customers' cost of ownership and shortens the time it takes to find and resolve issues. From global financial institutions and industrial conglomerates to governments and telecom companies, enterprises around the world employ a combination of CA's cross-platform solutions and leverage the synergies between our Mainframe and Enterprise Solution products.

The interplay between Mainframe and Enterprise enables CA to cost effectively bring new innovation to the Mainframe market. This supports our customers' commitment to the platform. It also supports a seamless user experience by making it much easier for customers to manage instead of coordinating a number of disparate point-solution vendors.

There is no doubt that we are continuing to make progress towards our goal of building this company for long-term, sustainable growth. Our development organization continues to improve as we focus on making products that matter with improved user interfaces that are easy to deploy and easy to manage. Success here will better enable us to leverage channel opportunities and grow through alternative routes to market.

Our sales organization has also seen considerable improvement. For example, looking at our Platinum Net Promoter Score, or NPS, which is based on a survey designed to measure the willingness of customers to recommend CA to other customers, our scores continue to trend positively. More broadly, our customer satisfaction scores are also following a similar positive trajectory. We know that when we are at our best, we are customer-centric, results focused, self-aware and agile.

While our performance in Named and Growth, our partner-led businesses, was uneven in Q1, we continue to view this as a significant opportunity for CA to meaningfully expand our market reach. We have just started to scratch the surface. We will continue to make adjustments and be agile in our approach to driving continuous improvement throughout the organization.

Overall, I am very encouraged by our progress across a number of fronts. But as I've said before, progress will not be linear. We have had a very good Q1, but we face an incredible difficult new sales compare in Q2. We are on a journey to transform this company to one of sustainable, long-term growth. We still have work to do.

That said, I'd like to be the first to invite you to come and see some of the fruits of this work at CA World this year. We will host a financial analyst track on November 16 which will provide a great opportunity to speak with a number of people on our executive team, experience a broad array of our solutions in action, and hear what are customers are saying firsthand. There really is no better way to fully capture the CA picture than to experience CA World for yourself. We will be sending out save the dates with a registration link shortly.

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

Rich Beckert - CA Technologies - CFO

Thank you, Mike. And thank you all for your continued interest in CA. As Mike mentioned, after 10 years here at CA, I am announcing my retirement. I am proud to have been a part of the substantial change that has taken place over the years and to be in a position to leave CA in capable hands. I am confident that a solid foundation is in place to support the next phase of CA's journey.

As usual, before we get started with the quarterly review, let me remind you that all comparisons are year-over-year and in constant currency, unless otherwise indicated. This afternoon I am 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.

Our Q1 total revenue was \$999 million and up 3% in constant currency and 2% as reported. As Mike mentioned, this was the second consecutive quarter we've grown revenue year-over-year in constant currency.

Q1 Enterprise Solutions revenue increased 10%, Mainframe Solutions decreased 1%, and Services declined 2%.

Q1 total new product and capacity sales were up in the mid-50s and low 50s, as reported. Organic sales were up high 20s and mid-20s, as reported. Both organic and inorganic new sales were driven by the SI. The large system integrator contributed high 40s to the total new sales growth. Acquisitions contributed high 20s to total new sales growth. The increase in Q1 total new sales excluding the large SI was primarily due to Mainframe Solutions new product sales.

Q1 renewals more than doubled year-over-year, both in constant currency and as reported. As we have previously stated, the year-over-year change in our renewal bookings can vary on a quarterly basis due to the timing of large transactions.

The large system integrator transaction replaced an existing deal that was scheduled to expire in FY18. This new transaction provided an incremental contract value in excess of \$475 million and extends the agreement an additional five years. As such, we now expect FY17 renewals to be up in the high teens year-over-year as compared to FY16 in constant currency and as reported.

Renewal yield for the quarter in the low 90s percent range, in line with our long-term target.

Turning to geographies, new sales were particularly strong in North America, driven by the large system integrator transaction. New sales were also strong in EMEA. However, new sales were down in APJ and down sharply in Latin America, due to continued macro economic challenges in the region.

As Mike mentioned, revenue grew across all geographies in constant currency. On an as reported basis, revenue grew across all geographies except Latin America, where revenue decreased slightly.

Within our segments, Mainframe new sales more than doubled year-over-year in constant currency and as reported. The large SI transaction contributed slightly more than 100% of the greater than 150% Mainframe Solutions new product sales growth. Overall, we continue to expect our Mainframe revenue to be down in the low single digits over the medium term, which we believe is in line with the mainframe market.

Enterprise Solutions new sales increased in the low 20s year-over-year in constant currency and as reported. The large SI contributed in the high 20s to Enterprise Solutions new product sales growth. Areas such as Security, Agile Central, PPM, UIM and APM contributed to the new sales growth in the quarter. However, as we've discussed in the past, within Enterprise Solutions there are products in our Enhanced portfolio that are more mature and not growing but contribute to margin and cash flow. Acquisitions contributed mid-30s to new sales growth within Enterprise Solutions and were a notable contributor to the value we were delivering in the large SI transaction.

Services revenue decreased 2% in constant currency and 3% as reported. Over the long term, we expect Services revenue to decline, as we design our products to be easier to install and as we leverage partners.

Total revenue backlog improved to up 15% in constant currency and up 14% as reported. Current revenue backlog improved to flat in constant currency and as reported. As we've said in the past, current revenue backlog will likely grow after we demonstrate multiple quarters of new sales growth while maintaining a low 90s renewal yield. We expect current revenue backlog to fluctuate this year.

Q1 non-GAAP operating margin was 39% and GAAP operating margin was 29%. Operating margin declined year-over-year, primarily due to the impact of a favorable legal development in the year-ago period. Segment operating margins in the quarter were 62% for Mainframe Solutions, 13% for Enterprise Solutions, and 3% for Services.

Our Q1 GAAP and non-GAAP tax rates were 29%.

Q1 non-GAAP diluted earnings per share was \$0.64, down 2% year-over-year and flat as reported. Q1 GAAP diluted earnings per share was \$0.47, down 4% and flat year-over-year as reported.

Our Q1 CFFO was \$161 million, down 10% year-over-year or down 14% as reported. CFFO declined year-over-year due to the timing of cash taxes, which were lower in the year-ago period. Single installment cash payments were \$23 million, down year-over-year.

We ended Q1 with approximately \$688 million in net cash. During the first quarter, we repurchased \$50 million in shares and paid \$107 million in dividends. We have \$700 million remaining in our original \$750 million share repurchase authorization.

As Mike said, our uneven performance in some product areas and in Named and Growth and partner-led opportunities are places we are focusing as we continue this journey to transform the Company to one that can sustainably grow, as we continue to work to improve the efficiency and productivity within our development organization. Simultaneously, we are working to drive continuous improvements across our sales organization so that consistency and velocity trend in the right direction across all geographies. Overall, we are getting better, but we have not yet crossed the chasm.

It is important to note that the current revenue backlog was flat in the quarter. Consistent with our prior commentary, we expect backlog will fluctuate through the year. The large SI deal that was signed in Q1 was great for CA, with the total deal size, aggregate revenue run rate, and associated renewal yield all representing very good metrics for us.

While the large SI deal had no impact to Q1 revenue and minimal impact to current backlog, it does substantially shift the renewal portfolio such that FY17 is now significantly larger and FY18 is naturally much lighter. Consequently, FY18 renewals are expected to decline year-over-year, due to the timing of the large SI. Otherwise, the renewal portfolio is substantially unchanged relative to our prior expectations.

As Mike mentioned, Q2 would be challenged by an extremely difficult compare due to the large SI that renewed in the year-ago period. This will be particularly evident in the new sales, which are expected to decline sharply. Conversely, we had acquisition-related expenses that should create a more favorable year-over-year compare from an operating margin perspective.

Now turning to guidance. Guidance is based on exchange rates of the last day of the preceding quarter, which was June 30, 2016. The guidance also assumes no material acquisitions

For the full year, we continue to expect total revenue to be in range of flat to up 1% in constant currency. This translates to reported revenue of around \$4.03 billion to \$4.07 billion.

We expect a full-year non-GAAP operating margin of 38% and a GAAP full-year operating margin of 29%, compared to prior GAAP operating margin guidance of 30%. GAAP operating margin and EPS guidance reflect the impact of the increase in our share price on stock-based compensation. We expect our non-GAAP and GAAP tax rate to be between 28% and 29%, consistent with our prior expectations.

Non-GAAP diluted earnings per share is expected to grow 1% to 3% in constant currency, consistent with our prior expectations. This translates to reported non-GAAP earnings per share of \$2.49 to \$2.54. GAAP diluted earnings per share is expected to grow 2% to 5%, compared to prior guidance of 3% to 6%. The change in our GAAP growth expectations reflects the impact of the increase in our stock price on stock-based compensation. As mentioned earlier, this translates to reported GAAP earnings per share of \$1.88 to \$1.93.

At the end of the year, we expect approximately 411 million shares outstanding and a weighted average diluted share count of approximately 414 million shares.

Cash flow from operations is expected to increase 1% to 5% in constant currency, consistent with our prior expectations. This translates to reported cash flow from operations of \$1.05 billion to \$1.09 billion.

For this Q&A session, we have asked Kieran to step in to field questions with Mike. I'll be here should there be any particular points where I can offer clarity, but we'd like to give Kieran the opportunity to step into this part of his new role. With that, we will open it up for questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Raimo Lenschow, Barclays.

Raimo Lenschow - Barclays Capital - Analyst

Thank you for taking my question. And Rich, all the best to you and Kieran, good luck. I have two quick questions. First of all, Mike, can you talk a little bit about the significance of that large SI renewal renewing earlier. There seems to be different dimensions that I could think about it, but I just wanted to hear it from you. And then I had one follow-up.

Mike Gregoire - CA Technologies - CEO

Sure. With respect to the large transaction, first of all, this was not something that we orchestrated. It was at the request of the customer and in an effort to support their business. But it ended up being a very tightly negotiated contract that has excellent metrics. We added \$425 million worth of net new value. It's a contract -- sorry, it's \$475 million of net new value -- and it takes us out for seven years. And when you take a look at this particular system integrator, our technology is going to be installed in over 1,000 customers. In it is a lot of our new technology. For example, PAM,



the Privileged Access Management, is part of that transaction, which we think is top of mind for most companies right now. And having that installed in that many particular accounts, I think is tremendous for us.

The other thing that's significant is we've locked up our three biggest customers for almost five years now. That gives us a lot of visibility and it gives us an awful lot of software running in an awful lot of customers where we have an opportunity to extend those relationships over time. So it's a pretty significant transaction, as you can tell by the size of it and how it's affected our operating metrics. And I couldn't be happier with the team that negotiated it and I really do like the characteristics of the transaction.

Raimo Lenschow - *Barclays Capital - Analyst*

Perfect. And then, Mike, in history at some point you will be measured also, beside the renewals and the selling into these big contract renewals, on the performance of the stand-alone business. Can you talk a little bit about to what you're seeing there? I saw some comment -- you obviously made some comments about named accounts, et cetera, but how do you see progress there evolving? Thank you.

Mike Gregoire - *CA Technologies - CEO*

Yes, on the Named business, as expected, it's going to be a little choppy over time. The hardest thing for us to do is to sell new software to a net new customer. Almost all of our energy for new on the product side, on the marketing side, on the sales side, is equipping that sales team with the tools and capabilities to be able to sell our products into customers where we don't have a significant relationship.

Now the volume of transaction is going -- are going up, and I'm pretty pleased with that. But we need to have more product and we have to have more customers buying in that space. I think there's things that we can do product-wise, I think there's things that we can see marketing-wise with our compete level, and I also think there's things we can do from a sales effectiveness perspective to make that more repeatable over time.

And this really does lead into how I've changed the tone with respect to product and sales. I think this is not a unique issue with respect to CA. I think this is an industry issue. Customers today, they want to talk to sales professionals that really understand them and their line of business and how our products work in the context of their operation. That's why you see so much focus on try and buy and proof of concept in the selling motion.

Secondly, if you're building products, especially if you're building Agile, you have to have customers participate in the build very early on in the design cycle. We need our sales teams to have the relationships and accounts where they are willing to participate in our design, because if they participate in our design, the probability that we build an application that absolutely solves a group of problems for a wide variety of customers goes up.

At the end of the day, customers want products that are easy to install, easy to upgrade, easy to operate, and having both Ayman and Adam focus on that together I think is going to have a material impact to our overall consistency and our ability to sell, not just in platinum, but also in the Named and Growth space.

Raimo Lenschow - *Barclays Capital - Analyst*

Perfect. Thank you.

Operator

John DiFucci, Jefferies.



John DiFucci - *Jefferies LLC - Analyst*

Thank you. First of all, I'd just like to say, I know Zack and I are going to miss Rich a lot. I know Kieran, it's in good hands right now, but we certainly will miss Rich. I have a couple of questions. In the first, I'm going to ask it around Mainframe, but I think it applies to everything. And the question is for Kieran, but either Rich might want to chime in, or even Mike, too. You said you expect this business to be down low single digits, which is what's expected for the industry, but assuming this is all ratable business, you had a big, large, new Mainframe business quarter, right? I'm curious, did new business in this quarter more than offset attrition in this quarter, if you're looking at annualized numbers? And if so, which it seems like it probably did, why couldn't it actually grow? Other than you being prudently conservative in your forecast, which makes a lot of sense in this business, especially a business that some describe as a melting glacier.

Kieran McGrath - *CA Technologies - Interim CFO*

So, John, it is Kieran. I think the first thing I'd say is prudent, we are definitely prudent in the business. We've had a very good run of it here over the last several quarters with the Mainframe new sales performance and we've been very pleased with all of our renewal metrics. And we think with the amount of capacity IBM is putting out into the marketplace, we get to populate that.

I do think we would be somewhat naive if we were to ignore the overall market trends, at this point in time. We think the minus 1% here is a pretty nice improvement that we've seen. If you recall a year ago, we were running at about minus 3% for the first half of the year and we've made steady improvement in that space. Right now, from what we can see, low single digits seems very doable, very manageable and actually very much in sync with where the market is. Obviously, any opportunity to do better than that, of course, the team will take advantage of that. But that's where right now, we really just expect it to be down in the low single digits.

Mike Gregoire - *CA Technologies - CEO*

The other thing, too, John, that I would add to it, is this is not a business that we're ignoring. This is a business that we're paying very close attention to. I think we're probably one of the only two vendors that are making serious investments in R&D in the Mainframe business. When you take a look at how that product group has done, they've done a fantastic job. They've put out 53 new releases in the last year with zero defects. And when we talk to that customer base -- as I said before, we are getting very maniacal of listening to the customer -- what they want is high quality releases. These are mission critical systems running high transaction through put. They want software that works all day, every day. And when I take a look at what that team has done, especially over the last year as they've adopted Agile, they have just absolutely gotten better.

And I know Rich is very close to this business. Maybe you have a couple comments, Rich, on the Mainframe.

Rich Beckert - *CA Technologies - CFO*

Hello, John. The only thing I would add to that is it is very much what's in the portfolio to renew. If you recall in Q4, it was lighter Mainframe, this quarter was a heavy Mainframe quarter. Next quarter, difficult compare with the prior year's outsourcer. So, yes, if you did this kind of quarter every quarter, you're correct, it would be growing, but that's not how it will happen. It will porpoise.

As far as IBM's Mainframe, all the work that we've done internally, they're right on track with their -- in fact, on a year to, inception to date basis on their current product line, they're probably actually doing better than the previous one from what we can see. So we are happy with the progress. There's always going to be price pressure, as you know, on the MIPs that we're putting on the floor. But as Mike said, we think we're poised very well to pick that up and be one of the two main providers for Mainframe.

John DiFucci - *Jefferies LLC - Analyst*

Okay. Great. That's helpful on that business. Just my second question, I'd like to turn to, it's going to really focus on the other business, the Enterprise Solutions business. You talked of uneven performance in Named and Growth business, which is going to be mostly Enterprise Solutions, I think.



Can you provide a little more detail around what that means as far as uneven performance? Because actually we hear about that in the field, too. We actually hear of wins that you guys are making outside of your existing platinum accounts and you hear those things and you're like, wow, that's pretty interesting. But what do you have to do to make that more consistent? You mentioned that in your prepared remarks, that you're going to do that, but what is it that Adam is going to put in place to make that more consistent?

Mike Gregoire - *CA Technologies - CEO*

You know, it's a great question. And trust me, I ask myself that question a lot and I try to get as many people in the company to provide answers. And what we've come up with is a large list of things that I think we can do better in that space. We had an absolutely fantastic quarter, but we spent an awful lot of time consistently being agile, taking a look at what we can do better. And the inconsistent performance is, some of it's people related, some of it's leadership related, some of it's product related, and some of it is industry related.

You take a look on a global basis, we're spotty. We have quarters where sales teams are doing a really good job of getting to understand line of business leaders and really getting tight relationships and understanding their buying process, and we have other areas that they have not been able to penetrate into some of those accounts.

Now some of that is brand and brand recognition. And you have to remember that for -- we're a 40-year-old company. For 37 years of that, we basically sold to between 100 and 200 customers. And now we're expanding our TAM, trying to get into the other 1,700 customers that buy enterprise software, and they just don't know CA as well as they should. The brand marketing that we're doing with CNN gets us to be known. The work, especially in Europe, that we've done with Trek and the cycling team has been phenomenal for people asking the question is, what is CA?

So we're getting some brand awareness, and I think that's helping the sales force. Coupled with that is a lot of product improvements. We've been changing the product to get to where those types of customers want to buy. They want easy to use, they want easy to buy, they want easy to upgrade. They want to understand how that product works before they buy it. And I think that's not a CA phenomenon, that's an industry phenomenon. I think that as you are building out net new product, if it doesn't have those types of characteristics, it's going to be harder and harder to sell.

When you take a look at our product portfolio, we have a number of products that do that and do that very well, but we don't have enough of them. And when I work with Ayman and I work with Adam, those are the things that we're trying to drill down on.

Now secondly, we've made pretty big investments in digital marketing, which has had an uptick for us, but is still early days with that. When you put all of that focus together, I think you're going to see definitely more consistency in the Named segment, but it's a work in progress for us.

We get our revenue from a number of different places, John, as you know. You've got one of the most sophisticated models out there. We know how to do renewals. We're good at that. We know how to upsell in a renewal and extend the size of the wallet in an account. We know how to do that real well. We have been doing a much better job over the last two years of selling outside the renewal. And there's always room for improvement there, but we know how to do that.

When it comes to capacity sales, that's not something that we get to drive as much as some people would like to think. At the end of the day, you either need capacity or you don't; and to the extent that customers need capacity, we absolutely know how to do that.

The hardest thing for us to do that we are getting better and better at each and every quarter is cold calling into a customer that we have little or no relationship with, explaining what CA is, explaining what it is we can do to help them, and that's taking time and we're going to keep at it all day, every day. Is that helpful?

John DiFucci - *Jefferies LLC - Analyst*

That is helpful, Mike. Sounds like you have a lot to do and all of that probably will contribute to, hopefully to success here. Thank you.

Mike Gregoire - CA Technologies - CEO

Absolutely.

Operator

Walter Pritchard, Citigroup.

Unidentified Participant - - Analyst

Hello. This is actually Jim on for Walter. Just wanted to say congrats, Rich on your retirement and your future endeavors. I'm sure you will enjoy the time off. So I just wanted to start off on the SI deal. The \$475 million renewal is the same customer as the \$300 million that we were supposed to have in 2018. How should we think about what is renewal or the extension component with it being seven years versus new business being sold into it?

Kieran McGrath - CA Technologies - Interim CFO

Yes, it was a component of both. So from a renewal perspective, we certainly had a very substantial set of metrics on it. And associated with that, we also had a lot of new sales, both from the Mainframe and from our PAM business, our Xceedium business, which were both of them in here. So it's an extension of a deal that would have expired in December of next year. And essentially, it's another five-plus years that we get, so in total now seven years out. But it was a healthy mixture of both new sales, as well as very good renewal metrics.

Unidentified Participant - - Analyst

Got it. And then what would be the impact for the merger of HB Services and CSC on you guys? Have you guys thought about that? And just looking for your thoughts there.

Mike Gregoire - CA Technologies - CEO

If you take a look at it, the three largest SIs are contracts that we have locked up for almost five years. So we have HP locked up, we have IBM locked up, and we have CSC locked up. The contracts that move with HP over to CSC, when they close that deal, those contracts are locked up. That was for at least another four years. So I think we're very well protected from a revenue perspective and I'd like to help grow those accounts as they start implementing our software in their SI contracts.

Rich Beckert - CA Technologies - CFO

If I could add to that, Jim, I think what you're going to see over the last three major SI deals, what Mike just described, we were happy with all the metrics on that. So the overall wallet share, the renewal yield, and what new products we put in, both organic and products that we acquired. And the way to view that as the relationships, as Mike had pointed out earlier, are getting deeper and deeper, not less and less. So that's all been a positive for CA over the last couple of years.

Unidentified Participant - - Analyst

Got it. Thank you. Thanks, guys, and congrats again, Rich.



Operator

Michael Turits, Raymond James.

Jeremy Benatar - *Raymond James - Analyst*

Hello, guys. It's Jeremy Benatar on for Michael. Adding on to Jim's question, I was wondering if the large SI deal that was pulled in from FY18 could drive further add-on sales this year, and if so, is that accounted for in your annual guide, given the full-year guidance was maintained?

Kieran McGrath - *CA Technologies - Interim CFO*

This is Kieran. So first of all, it's because the deal is over seven years. And even though, with the revenue, it's all ratable revenue, it's going to have a de minimus impact on revenue, and there was no impact on revenue in the quarter. And as we go forward, it will be very small for the rest of the year. Certainly, we've got a very close relationship with that group now and we'll always be looking to sell into that account and find more upside.

Mike Gregoire - *CA Technologies - CEO*

If I were to add to that, also what you will see is they standardized on some of our products like PAM. And anytime they standardize, as we add to that product either through acquisition or organically, it allows us to further -- there's 1,000 customers there. We talk about it as one big customer. It's actually 1,000 customers that come and go in and out of those three outsourcers. So it makes a great platform for us. And I think as we go forward and continue to build out the security platform, as an example, this allows you to upsell. Because remember, they only have access to what we have today, not what we build or buy over the next seven years.

Jeremy Benatar - *Raymond James - Analyst*

Okay. Thank you.

Operator

Gregg Moskowitz, Cowen and Company.

Gregg Moskowitz - *Cowen and Company - Analyst*

Thank you very much and congratulations to you, Rich, as well. You referenced earlier an increase in Mainframe Solutions renewals that were actually not associated with the big SI deal in the quarter. Just wondering if you could elaborate on that.

Kieran McGrath - *CA Technologies - Interim CFO*

Yes, it was the team. Based upon, we discussed earlier, with IBM's new product releases that have been out for the last year and a half or so and all the incremental capacity that's been put out into the field, we've had the opportunity to actually fill up a lot of those slots with increased MIPs. And this is several quarters in a row for us that we've been able to do that, as well.

Mike Gregoire - CA Technologies - CEO

And remember, we lag -- they install the product. They don't actually come to us for MIPs for usually six months afterwards. So although their year-over-year sales are down, they're still putting more MIPs in the marketplace. So that's an absolute number is expanding. Our installed base is expanding and we pick those MIPs up upon the next renewal, unless someone is busting out of the top of their -- what they have capacity for. So it's exactly as Kieran said.

Gregg Moskowitz - Cowen and Company - Analyst

Okay. Perfect. Then just another question for either Kieran or Rich. You mentioned that Q1 total new product and capacity sales were up, I think, mid-50s in constant currencies and I think within that, the large SI contributed high 40s to total new sales growth, and acquisitions contributed high 20s. I presume there's some overlap there just in terms of the fact that the SI bought quite a bit of PAM in the quarter, but just wondering roughly what the new sales growth would be or would have been on an organic basis and if you excluded that one large deal in the quarter?

Kieran McGrath - CA Technologies - Interim CFO

There certainly was a very substantial portion of overlap, absolutely, in the deal. But even with that, organic sales would still have been up in the quarter.

Mike Gregoire - CA Technologies - CEO

Yes, if you take a look at, as I put in my prepared remarks, Product and Portfolio Management had a very strong quarter, that's all organic. UIM, especially with the new release, was strong again. APM, strong again. Rally was another strong quarter for us. So when you take a look at a lot of these -- the Rally would probably be excluded out from organic -- but when you take a look at another transaction we did with PAM, although the product is not organic, there's no way that that sale would have got done without our sales force. So I think that's quasi organic or inorganic, but it was the biggest, the second biggest transaction, I think, PAM has ever done. And it would never have been done without the relationships that we have.

Kieran McGrath - CA Technologies - Interim CFO

We took a business and scaled it orders of magnitude from the run rate that the business was on a year ago.

Gregg Moskowitz - Cowen and Company - Analyst

Right. Absolutely. Just one last one for Mike, if I could. What's your expected time line with respect to the CFO search, and as well, what are the primary characteristics that you're looking for?

Mike Gregoire - CA Technologies - CEO

Sure. First of all, industry. We have been meeting with search firms. We'll make a call on that relatively shortly. But based on heuristics, you're looking four to six months. And what we're looking for is a CFO that exhibits a lot of the characteristics Rich has with respect to rock solid financial performance, the ability to understand our business, ability to grow and nurture a team. And also, we're good to do acquisitions, so I want to make sure that that CFO has the ability to understand they dynamics of doing acquisitions. And lastly is this maniacal drum beat of paying attention to customers. Paying attention to customers has to be the focus of everybody in the Company.

Now the tip of the spear usually shows up in sales and in product, but how you model, how you budget, how you think through all of the things that customers are driving us for, I think a CFO plays a pretty strategic role in helping all of the business units think that through and make sure that we're organized from a financial perspective to understand that.

Gregg Moskowitz - *Cowen and Company - Analyst*

Terrific. Thanks very much.

Operator

Shaul Eyal, Oppenheimer.

Shaul Eyal - *Oppenheimer & Co. - Analyst*

Thank you. Hello. Good afternoon and thank you for taking my questions. Good luck to Rich, as well congrats to Kieran. Mike, good performance across the board, strong performance on the security front. Can you talk to us as to the ongoing success you are seeing in recent quarters? Is it the toxic landscape on the security front? Is it the growth in compliance and regulation, all of the above? And excluding the SI contract, did Xceedium still have a strong quarter on a stand-alone?

Mike Gregoire - *CA Technologies - CEO*

Yes. Xceedium has been a big bright spot for us in security. We also have another product that did very well in security, it's called Payment Security. So we are definitely very focused on taking advantage of a number of unique things happening in that security market space.

First of all, the market is continuously growing. There's no winner across the board in security. Customers are leaning towards companies that have more scale and more breadth, because they're looking for global service on a topic like this. They would prefer to deal with fewer vendors rather than stitch together the security platforms of multiple vendors. The fact that we've got a very large portfolio and are dominant in the ID management space, I think puts us in a very good position to compete.

As we get closer to CA World, you're going to see us put out more organic product with respect to security. And I think that the way that we think through security and the way that we're thinking through how the security, the future operates with predictive analytics, is unique to the market space. So I'm pretty bullish about what we're able to do in security over time.

Shaul Eyal - *Oppenheimer & Co. - Analyst*

Got it. You have been front running my next question. But what additional security markets could you be thinking of expanding into, or the focus is mostly likely to remain near-term on identity and access management?

Mike Gregoire - *CA Technologies - CEO*

We still think that there is a lot of work to be done in identity and access management governance. A lot of that work, whether it be in the cloud or whether it be on-premise, the other thing is ease of use. All the products in the marketplace today are not as easy to use as customers want, and oddly enough, this is something that really requires a lot of insight and intellect, because we can lock things down pretty tight. The user experience becomes more difficult, the more tighter we lock things down. Customers push back on that and end users push back on it even harder.

So the real secret is to make an elegant solution that is very robust, very safe, provides an incredible amount of governance and reporting, and makes it easy for the users to do what it is they want to do. And a lot of that's going to be based on predictive analytics. And when you take a look at some of the work we've been doing over the last year in this space, I'm pretty excited about our role to be able to use that type of technology to help solve that critical problem.

Shaul Eyal - *Oppenheimer & Co. - Analyst*

Got it. So automation, orchestration also on the table in that respect, if I'm reading you right?

Mike Gregoire - *CA Technologies - CEO*

With respect to security, once again, the day a new customer or a new employee wants to use any digital service, to the extent that you know who they are, you know where they're coming from, you know what their rights are inside your enterprise, a lot of that work, if you call that orchestration, yes, absolutely, we are 100% behind that. I just want to make sure that people aren't confused with the word orchestration. Orchestration in a dev ops world means something completely different. And although that's a big part of our business, as well, when it comes to security, it's really about ease of use and protection, as well as reporting in on behaviors and patterns.

Shaul Eyal - *Oppenheimer & Co. - Analyst*

Fair enough. Thank you so much and good luck.

Operator

Kirk Materne, Evercore ISI.

Fenn Hoffman - *Evercore ISI - Analyst*

Hello. This is actually Fenn Hoffman on for Kirk. Thank you for taking my question. We touched this a little bit, but I just wanted to come back to it. It's been a while since your last acquisition. I know you said in the past that you generally aim for \$300 million to \$500 million in acquisitions per year. Can you give us an update on your thinking in terms of the balance you're looking for between capital return and inorganic growth going forward? Thank you.

Mike Gregoire - *CA Technologies - CEO*

Sure. We have a three-legged stool that we continuously talk about with respect to capital allocation that shows up with it, as you said \$300 million to \$500 million a year in doing acquisitions. And we're all for doing acquisitions, but we are going to be very disciplined. And our discipline shows up in two places.

First of all is what it is we're buying. What we're buying has to fit in the context of our strategy and we are very specific with respect to what that is. We wouldn't want to be more than a standard deviation outside of the core tenets of our strategy. We're not chasing revenue, we're not chasing fads. We have an intimate idea of what enterprise software is going to look like in the future. And to the extent that we could find great technology that fits that strategy, we're all in.

Secondly is we are disciplined buyers. We have been very thoughtful, I believe, with respect to what we're willing to pay for technology. And to the extent that we can find something that fits our strategy and fits our price point, we are more than happy to transact. If we can't solve those two minimal hurdles, it's just hard for us to find acquisitions that really make sense.

Fenn Hoffman - *Evercore ISI - Analyst*

Okay. Great. Thank you very much.

Operator

Abhey Lamba, Mizuho Securities.

Unidentified Participant - *Analyst*

Yes. Thank you. This is [Parsip] sitting in for Abhey. You mentioned that you now expect the renewal portfolio to decline in FY18 as the SI deal shifted into FY17. Can you provide any color on the revenue side of things? I know you're not willing to talk about FY18 revenue just yet, but are you still comfortable with your directional goal of growth in FY18?

Mike Gregoire - *CA Technologies - CEO*

Directionally, we are very comfortable with what we've said, mid-single digit growth.

Kieran McGrath - *CA Technologies - Interim CFO*

Low single digit growth.

Mike Gregoire - *CA Technologies - CEO*

Low single digit growth. And we're not going to get into FY18. We're in the first quarter of FY17. We'll approach that at the appropriate time.

Unidentified Participant - *Analyst*

Great. Thank you. And as a follow-up, Rich, can you give us a sense of why you thought it was best to transition at this time from your role at the organization when it seems like momentum is moving in the right direction?

Rich Beckert - *CA Technologies - CFO*

Sure. Well, first, I've been here 10 years, 5 years as the CFO. I want to thank Mike for all the work that we've done together and the Board's help in allowing me to have the 5 years of opportunity. I couldn't have done it without my team. We've built a great team out over the last 10 years. Kieran, I'm sure as you get to know him over the next few weeks and months, will find that to be the case. So I think I'm leaving at the right time. It's two quarters in a row of revenue growth and the stock's at a 52-week high, allows me to transition into a little bit of time off, honestly, and then I'll figure out where I go from here.

So I think it was perfect timing. And I think, Mike, I want to thank you publicly for all the three years. We have done a lot of things together as a team and he's built out a great team. So I think it's left in great hands.

Unidentified Participant - *Analyst*

Perfect. Thank you very much.



Operator

Greg McDowell, JMP Securities.

Greg McDowell - *JMP Securities - Analyst*

Great. Thank you. And Rich, I hope you're relishing the last few minutes of your last earnings call here. A few quick questions. First, you called out a couple times the difficult new sales compare from Q2 of last year and specifically called out that you expect it to decline sharply. I was wondering if you could just help us a little bit in putting some parameters of what decline sharply exactly means, just to make sure we get the modeling right. That's my first question.

Kieran McGrath - *CA Technologies - Interim CFO*

As you know, we don't tie it to quarters, specifically. But it was a very substantial deal that we booked last year from both the renewal and a new sales perspective. So I think just given what we say, you ought to expect that we're going to be down. In addition to that, we also wrap on our two big acquisitions next year, in particular with Rally. So it's certainly going to be the most difficult quarter for us for this year. We had a very, very strong Q2, both organically and inorganically last year, with the large SI, as well as without the large SI. So when we look across the whole year, this was the quarter that we always thought would be the one that was going to be the most challenging for us.

Greg McDowell - *JMP Securities - Analyst*

Okay. That's helpful color. Thank you. And then no one has asked yet about some of the geographic commentary you made. And it's always surprising to hear that EMEA was strong. So I was just wondering if maybe you could give us some more details on what exactly happened in EMEA, what you saw at the end of the quarter in the UK, and maybe how the pipeline specific to the UK is shaping up in light of the headlines? Thank you.

Kieran McGrath - *CA Technologies - Interim CFO*

Yes. So overall, EMEA actually had a good quarter. We had a lot of strength in our northern and central regions. As Mike had said, we do need to see more consistency, especially in EMEA growth. We had some pockets there where it performed well, but in general, could have done a better job there. We actually saw some really strong performance in our PPM, UIM and APM products, and it was great news that EMEA was actually up on a year-on-year basis.

As we exited the quarter and going through this year, right now we're not seeing anything per se reeling its head from Brexit. But we'd be prudent just to keep an eye on that and to not get too far ahead of ourselves here. But so far, we'd say EMEA was performing fairly well.

Greg McDowell - *JMP Securities - Analyst*

Thank you.

Operator

Thank you. And that does conclude our Q&A session for today. I would now like to turn the call back over to Mr. Mike Gregoire, your CEO, for any further remarks.

Mike Gregoire - CA Technologies - CEO

First of all, thank you for joining us this evening. I'd like to leave with a few closing thoughts. First of all, we're off to a great start here in FY17, with revenue up for the second consecutive quarter, strong new sales, and a solid margin performance. That said, I think we've pretty hammered this point home pretty hard, we've got a difficult compare coming in Q2, especially with regard to new sales.

I'd also like to publicly acknowledge Rich, as well. It's been a great partnership over the last three years. He's taught me an awful lot. He taught me the Mainframe and he also taught me financial discipline at scale. So, Rich, thank you very much for all that you've done.

And lastly, we look forward to updating you as we continue to evolve CA. And as I mentioned earlier, we're a software company. If you really want to understand us, do your very best to get to CA World. We have a lot of net new technology coming out between now and CA World. I think it's going to be our biggest CA World so far, and it's really going to be focused on product and how we're building products that are easy to use, easy to install, and easy to maintain. So with that, thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone, have a great day.

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