1Q18 Earnings Conference Call Script
Final

**Traci Tsuchiguchi:**

Thank you and good afternoon everyone. Welcome to CA Technologies' First Quarter 2018 Earnings Call.

Joining me today are Mike Gregoire, our Chief Executive Officer, and Kieran McGrath, our Chief Financial Officer.

Mike and Kieran 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, August 2nd, 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 U.S. 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, both GAAP and non-GAAP financial measures will be discussed.

Reconciliations of non-GAAP financial measures 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 including our annual report on Form 10K for a detailed discussion of potential risks. Please note that our second quarter quiet period begins at the close of business on September 15th, 2017.

Please note that all comparisons are year-over-year and as reported unless otherwise indicated.

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

**Mike Gregoire:**

Good afternoon. Thank you for joining us.

Before we begin the discussion of our Q1 performance, we recognize that there have been rumors and speculation around M&A transactions. Our policy is not to comment on rumors and speculation. We are confident in the progress that we have made towards achieving sustainable, profitable growth over the medium-term planning horizon. We believe that we have a strategy in place that will result in long-term value for our shareholders. Management and the board regularly evaluate and pressure test our assumptions and consider risk-adjusted strategies to realize long-term shareholder value. We will not respond to any questions about rumored M&A transactions or to speculate about future transactions.

Now, turning to our first quarter performance. I am pleased that the momentum from fiscal year 2017 continued into our fiscal first quarter. Revenue, operating margin, earnings and CFFO all came in above our expectations. Following strong performance in fiscal 2017, our first quarter revenue and earnings results have given us a great start to the new year. Our Q1 performance increases our confidence, and we are very pleased to be in a position to raise our fiscal year 2018 guidance.

The upside relative to our expectations was driven largely by better than anticipated performance from our recent acquisitions as well as continued discipline around expense control.

As expected, all of our bookings-related metrics, including new sales, were significantly impacted by the very difficult compare relative to the year ago period. Recall that in the first quarter of fiscal 2017, we renewed a large System Integrator early, at the customer's request. It's worth mentioning that even outside of the large SI, our renewal portfolio in the quarter was smaller than in the year ago period. While new sales were down because of this dynamic, total new sales, Enterprise Solutions new sales and organic Enterprise Solutions new sales all out-performed the year-over-year decline in the renewal portfolio. Our renewal yield in the quarter was in the mid 90s.

Mainframe new sales were particularly impacted by the difficult year-over-year compare. That said, we are very pleased with the continued strong performance from newer products like Data Content Discovery and Mainframe Operations Intelligence. The pivot we have made towards more of a solutions-based sale is gaining traction as we are now more succinctly articulating our ability to help customers solve specific challenges. Our focus on quality, our zero defect policy, and our SKU-simplification efforts with our Mainframe business unit reflect our on-going commitment to driving continuous improvement.

The investments we are making in customer experience and customer success has consistently increased CA's Net Promoter Score – or NPS® - an industry standard measure of customer loyalty. In Q1, CA's NPS score improved dramatically compared to the year ago period. The percentage of customers that consider CA to be a "strategic partner" increased, our customer satisfaction scores continue to rise, and customers are rating our product quality higher.

Leading industry analysts are also recognizing CA's innovative product development and strong ability to execute. In the quarter, CA was positioned as a Leader in the June 2017 Gartner Magic Quadrant for Access Management, Worldwide. The report evaluated CA's broad identity and access management portfolio along with the company's ability to execute and completeness of vision. CA was also named a leader in the May 2017 Gartner Magic Quadrant for Project Portfolio Management, Worldwide. The report evaluated CA Project & Portfolio Management and positioned CA highest in the Leaders quadrant for Ability to Execute. Also in the quarter, CA was named a Leader in the April 2017 Gartner Magic Quadrant for Enterprise Agile Planning Tools. This report evaluated CA Agile Central, an enterprise-class platform purpose-built for scaling agile development practices. This recognition is great validation of the work our development teams are doing every day.

In the quarter, our API Management team, which delivered very strong new sales growth, released new versions of API Developer Portal and API Management SaaS. By integrating the data analytics engine that exited the CA Accelerator – our VC-like technology incubator – the total cost of ownership is lowered. Its single, cloud-native code base enables same-day delivery for SaaS, hybrid-cloud and on-prem versions. The team also launched a Microservices Solution to help developers and enterprise architects create and deploy microservices and manage the APIs that connect and orchestrate microservices. Docker® container deployment options are now available across a number of products within the API Management portfolio. And, expanded integrations have been made across CA's product portfolio to address management, security and advanced monitoring of APIs for modern architectures across any enterprise or cloud environment.

Now, turning to our recent acquisitions. As I mentioned earlier, we are very pleased with the rate and pace of integration and the Q1 performance of both Automic and Veracode. This upside relative to our expectations drove better than expected performance for CA overall in our fiscal first quarter.

To date, the Automic team has already built integrations across a number of CA's products, including: Agile Central, Continuous Delivery Director, Service Desk, Test Data Manager, Blazemeter, and Service Virtualization. There will be more to come. Campaigns are now underway to promote these solutions to both historical Automic customers and historical CA customers to leverage existing relationships and cross-sell.

The response we've seen in these early days is very encouraging.  The Automic platform integrated across CA's portfolio is highly synergistic and has the opportunity to create tremendous value.

Similarly, the Veracode development team has been working very closely with its CA counterparts to further build out its platform to complement CA's portfolio and accelerate volume across the Veracode platform.  The strategic alignment with the Veracode acquisition is ideal, as it sits squarely at the intersection between DevOps and Security. We are very happy with the progress made so far, and we're thrilled by the opportunities that lie ahead.

After making some minor tweaks to the sales organization at the beginning of the quarter, we did not see any meaningful consequence to sales productivity.  As expected, new sales for the Enterprise sales group – formerly referred to as our Platinum sales team plus our largest Named customer group – declined year-over-year due to the large SI that renewed in the year-ago period.  New sales for the Enterprise customer group were significantly impacted by mainframe capacity.  We were pleased that both public sector and global commercial accounts grew new sales at a healthy clip.

As we've said in the past, we are an agile organization.  Following the pivot we made in the sales organization last quarter, we are actively looking at opportunities to improve the way in which we operate.  We are wholly committed to the concept of continuous improvement and are convinced that we can drive even stronger profitability and cash flow in the years ahead.

I'd also like to be the first to invite you to CA World in Las Vegas.  It's a great opportunity to see the breadth of our product portfolio, talk to our customers, and spend time with the broader executive team.  We will host an analyst event there on November 15$^{th}$ – we hope to see many of you there.

Overall, I am very pleased with our first quarter performance and our ability to take our full year guidance higher. As the momentum from a very strong fiscal Q4 and fiscal year 2017 has continued into the early part of fiscal 2018, we have increased confidence that these positive data points are beginning to form a trend.

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

**Kieran McGrath:**

Thank you, Mike.

Before we get started with the quarter review, please note that all comparisons are year-over-year and as reported 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 Mike mentioned, overall we were very pleased with our fiscal first quarter performance. Revenue, operating margin, EPS and CFFO all came in above our expectations.

**Bookings**

As noted on our last quarter's earnings call, we faced a very difficult compare in the first quarter of fiscal 2018 due to the renewal of a large transaction with a System Integrator in the first quarter of fiscal 2017. This was particularly evident in all of our bookings-related metrics, including new sales, in the quarter. Renewal portfolio size and duration heavily influence bookings metrics given the opportunity renewals provide to generate new product sales.

Q1 total new sales were down in the mid-20s, and organic new sales were down in the mid-30s. Excluding the impact of the large SI, total new sales were up approximately 10%, and organic new sales were down in the high-single digits. Total organic new sales, excluding the large SI, were impacted by the lighter renewal portfolio compared to the year ago period and commensurate lower mainframe capacity.

The total renewal portfolio was down in the high 50s compared to the year ago period. As we have stated on prior earnings calls, the year-over-year fluctuations in our renewal bookings vary on a quarterly basis due to the timing and duration of large transactions. As Mike mentioned, even excluding the large SI, the size of the renewal portfolio was lower by approximately 30% as reported and high 20s in constant currency.

Our renewal yield for the quarter was in the mid-90s percent range.

Organic new sales declined year-over-year across all regions due to the lighter renewal portfolio in the quarter compounded by the large SI renewal in the year-ago period.

Within our segments, Mainframe new sales were down in the mid-50s. Mainframe new sales were negatively impacted by the size of the renewal portfolio and related capacity sales in the period. Nevertheless, we are very pleased with the ongoing strength of our organically developed mainframe products like Data Content Discovery and Mainframe Operations Intelligence, both of which contributed to mainframe new product sales in the quarter.

Enterprise Solutions new sales were down in the low single digits, and organically were down in the low 20s. Excluding the impact from the large SI, organic Enterprise Solutions new sales were up slightly in the quarter, in spite of the lighter renewal portfolio. We believe this dynamic demonstrates that the recent improvements we've made, both from a product and go-to-market perspective, are beginning to materialize.

As Mike mentioned, the recent acquisitions of Automic and Veracode performed very well in the quarter and exceeded our expectations. We are very pleased by the rate and pace of both product and operational integrations, and are enthusiastic about the opportunities that lie ahead for both acquisitions.

**Revenue**

Total revenue for the first quarter was $1.025 billion, up 3% as reported and up 4% in constant currency. Acquisitions contributed approximately 6 points to total revenue growth in the quarter.

From a segment perspective, Enterprise Solutions revenue was up 12%, both as reported and in constant currency. Mainframe Solutions revenue was down 3% as reported and down 2% in constant currency, in-line with our longer-term expectation for the overall Mainframe market. Services revenue was down 3% as reported and down 2% in constant currency. As our solutions have become easier to install, deploy and manage, by design, our Services revenue has been impacted. That said, we believe that the rate of decline in Services revenue will begin to abate in the second half of this year.

Total revenue backlog was up 2% while current revenue backlog improved 6%, both as reported and in constant currency. Around 4% of the current backlog increase can be attributed to the acquisitions of Automic and Veracode. The remaining 2% was driven by organic factors, including the size of the renewal portfolio coming due in the next twelve months. As we've said on prior earnings calls, we expect that current revenue backlog will grow with more consistency after we demonstrate multiple quarters of new sales growth while maintaining a low 90's renewal yield.

**Operating Margin and EPS**

Q1 GAAP operating margin was 26% and non-GAAP operating margin was 37%. Segment operating margins in the quarter were 65% for Mainframe Solutions, 8% for Enterprise Solutions, and 1% for Services.

In the quarter, Enterprise Solutions margins were impacted by acquisition-related factors.  Mainframe margins came in above our longer-term target.  This reflects company-wide efforts to decrease corporate-level expenses that result in generally improved margins across all segments as well as the revenue mix shift and associated expenses to the Enterprise Solutions segment.

Our Q1 GAAP tax rate was 25% and our non-GAAP tax rate was 28%.

Q1 GAAP diluted earnings per share was $0.42, down 11% as reported and down 4% in constant currency.  Q1 non-GAAP diluted earnings per share was $0.61, down 5% as reported and down 3% in constant currency.

**Cash Flow**

Our Q1 CFFO was $298 million, up 54% as reported and up 52% in constant currency. The improvement in CFFO is primarily attributable to single-installment cash payments, which were $194 million in the quarter, and up meaningfully over the prior year.

We ended the first quarter with approximately $44 million in net cash. We paid $107 million in dividends in the quarter. We did not execute any share repurchases in the quarter.  As such, we have $650 million remaining of our original $750 million share repurchase authorization. We continue to expect that we will at least offset dilution with our share repurchase program.

**ASC 606 Update**

With regard to ASC 606, the new revenue recognition standard that we intend to adopt in the first quarter of our fiscal year 2019, you will see in our 10-Q filing tomorrow that we currently plan to use the modified retrospective transition method.  Additionally, as we mentioned last quarter, we are simultaneously considering ways in which to improve the transparency and simplicity of the metrics we provide on a regular basis to best reflect the on-going performance of our business.

**Guidance**

Now, turning to guidance. Guidance is based upon exchange rates on the last day of the preceding quarter, which was June 30th, 2017. No additional material acquisitions are assumed in our guidance.

Given the continued momentum and the outperformance of most key metrics relative to our expectations in the first quarter, we are pleased to raise our guidance for the full year.

For the full year we now expect total revenue to increase by approximately 4%, both as reported and in constant currency. This translates to reported revenue of $4.20 to $4.23 billion, and compares to our previous guidance of up 2% to 3% as reported and up 3% to 4% in constant currency.

In terms of revenue linearity through the year, we expect that the year-over-year revenue growth rate in constant currency will be between 3% and 4% in the first half of the fiscal year, with the second half of the year average in constant currency between 4% and 5%.

We expect our full year GAAP operating margin to be between 26% and 27% and our non-GAAP operating margin to be between 36% and 37%.

We expect our GAAP and non-GAAP tax rate to be between 28% and 29%.

We expect our GAAP diluted earnings per share to decrease by 8% to 5%, both as reported and in constant currency. This translates to reported GAAP earnings per share of $1.70 to $1.76, and compares to our previous guidance of down 10% to 7% as reported and down 8% to 6% in constant currency.

Non-GAAP diluted earnings per share is expected to be down 2% to flat, both as reported and in constant currency. This translates to reported Non-GAAP earnings per share of $2.42 to $2.48, and compares to our previous guidance of down 5% to 3% as reported and down 4% to 2% in constant currency.

At the end of the year, we expect approximately 412 million shares outstanding, and a weighted average diluted share count of approximately 415 million shares.

Cash flow from operations is expected to be up 1% to 5% as reported, and flat to up 4% in constant currency. This translates to cash flow from operations of $1.09 billion to $1.14 billion, and compares to our previous guidance of down 2% to up 2% both as reported and in constant currency.

With that, we'll open it up for questions.