F4Q16 Earnings Conference Call Script

Traci Tsuchiguchi:

Thank you and good afternoon everyone. Welcome to CA Technologies' Fourth Quarter and Fiscal Year 2016 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, May 11th, 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, 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 first quarter quiet period begins at the close of business on June 15th, 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:

Good afternoon. Thank you for joining us.

I am pleased to report that we achieved full-year results consistent with our guidance. Most performance metrics came in-line or above the high-end. Our FY16 performance demonstrates progress in our on-going work to re-position our product portfolio, refine our go-to-market strategy, and intensely focus on customer experience and customer success. This effort has culminated in our first quarter of revenue growth in nearly four years. However, our Q4 new sales execution was not as crisp as it could have been, a good reminder that we still have work to do.   We believe we are poised to cross-over into modest revenue growth for fiscal 2017 and over the medium term, deliver on our guidance of low-single digit growth. This is a big first step in our strategic goal of creating a company for long term sustainable growth.

For the year, revenue, operating margin, and EPS came in-line with our guidance range, and CFFO exceeded the high-end of the range. Total new sales in FY16 were up low teens year-over-year and organic new sales were up mid-single digits. This is the third consecutive year of step-function improvement in organic new sales.

For the year, API Management, Agile Central, PPM, Security and Mainframe were among the products that contributed to new sales growth. This broad-based improvement is encouraging and necessary to drive sustained growth given the size and breadth of our portfolio. While we are pleased with our progress, there is still work to do to achieve the kind of sustainable growth our company is capable of delivering.

Turning to our Q4 results, revenue grew 1% year-over-year. This is the first quarter of revenue growth CA has reported since Q1 in fiscal year 2013. In the quarter, API Management, Agile Central, PPM, and Release Automation all contributed to new sales growth with each of these areas up double digits.

However, the timing of renewals and shorter duration impacted our overall Q4 new sales performance. Recall that a number of transactions were realized earlier in the year, leaving less to close in Q4, as indicated in prior earnings calls. Regardless of the timing of transactions, we remain disciplined and committed to realizing the value we deliver to our customers.

As such, new sales were down high single-digits year-over-year, in-line with the renewal portfolio in Q4. While our free-standing Enterprise Solutions business grew in Q4 and Named and Growth or Partner-led business increased low-single digits, we are not satisfied. We should have done an even better job closing more opportunities outside of our renewal portfolio. Our results reflect that we are unwilling to pull deals forward and discount aggressively to amplify the results of any specific quarter or fiscal year. We are managing the business for the long-term best interest of CA and our shareholders. Looking ahead, we will be agile and deliberate as we make the requisite modifications to optimize our performance. This on-going self-evaluation and fast-learning is increasingly part of our DNA.

Consistent with this discipline, we are continuing to focus on customer experience. It is truly a firm-wide effort and one that we believe repositions CA from software vendor to technology partner. We see this on-going effort as a way in which we are elevating our brand in the eyes of both current and potential customers and in turn, driving a broadening set of new sales opportunities.

I'd like to point out a few of the transactions from the quarter that highlight how we are enabling customers in their journey of digital transformation and providing competitive advantage in the application economy.

Last year, we piloted a customer experience program aimed at supporting customers to ensure they realize the value of their CA solutions. Part of maximizing value from software is ensuring customers are employing the technology they have purchased and updating them to the latest releases with the best features. This effort has been so well-received that a global health insurance and benefits provider, an established customer across a number of our Enterprise Solutions offerings, now enlists CA's counsel on best practices with regard to our customer care and user experience initiative. They view CA as the gold standard by which other solutions providers are measured.

This customer had deployments of both CA Agile Central as well as two other agile management vendors. In the quarter, our sales teams closed a deal making CA Agile Central the enterprise standard for agile management. Our key competitive differentiators were: the compatibility and integration opportunity between CA Agile Central and CA Project and Portfolio Management, platform scalability, and portfolio-level analytics. This is a great example because it highlights the value customers see in integrated solutions from single vendors. It also demonstrates success in our land and expand strategy.

Another example of how we're enabling customers to thrive in the application economy is our relationship with a leader in the global money-transfer space. This company has been around for more than a century and competes in today's incredibly fast-paced, technology-enabled industry. With its continuous stream of new solutions for consumers and businesses, its DevOps vision and strategy are inseparable from its business outcomes. We are pleased that they have chosen to standardize on CA Release Automation to accelerate automation in their development processes, driving faster speed and improved quality.

The decision was made to expand CA Release Automation across the enterprise after achieving success in initial implementations. Our solution takes manual steps out of development and deployment of applications. This allows the customer to broadly benefit from the reduced time, cost and risk associated with application development.

This opportunity came on the heels of our Release Automation Continuous Delivery Edition, or CDE, which was made available in

February. This is a great example of how our organic efforts can create customer value which culminate in new and expanding opportunities for CA. Specifically, Release Automation CDE is an easily configurable, visual and strategic control point for optimizing processes, teams and applications. It supports collaboration and increases visibility while connecting delivered content with business goals.

As these customer examples demonstrate, the breadth and composition of our portfolio have become one of CA's competitive advantages. We remain committed to accelerating organic innovation. We are focused on creating meaningful solutions that are easier to install, easier to use, and easier to manage. With the roll-out of Agile Central across our development organization now essentially complete, we expect a more frequent cadence of higher quality releases that delight, inspire and enable our customers.

While organic innovation remains a priority, I am pleased to say that our acquisitions of Rally and Xceedium, now known as CA Agile Central and CA Privileged Access Management – or PAM – respectively, have exceeded their business cases and our expectations. We believe our disciplined, strategic, and methodical approach to acquisitions and our thoughtful and deliberate integration execution is bearing fruit. They are enhancing our ability to provide valuable solutions to our customers.

We are establishing a growing portfolio of products that are scalable, easy to install, and easy to manage. This, in turn, will accelerate our ability to sell into our Named accounts and Growth – or Partner-led opportunities. For example, in the quarter we won a competitive deal with CA Privileged Access Management at an iconic American health care and consumer products company. Following a proof-of-concept, this customer was pleasantly surprised by their ability to rapidly deploy our CA PAM solution and quickly demonstrate value.

Similarly, we closed an API Management transaction with one of the largest SaaS companies in the world. After observing the value of CA API Management at one of its acquired companies, a decision was made to expand its footprint. It is expected that billions of transactions will run through our API Management software by the end of the year.

Another Named account win in the quarter was with a multi-national pharmaceutical company that has chosen CA Project and Portfolio Management SaaS for its IT operations and, interestingly, its M&A activities. We view all three of these examples as beachheads from which we can grow our relationships, provide increased value with our broader set of solutions, and successfully execute our land-and-expand strategy.

Our sales strategy – specifically the separation of Platinum from Named, Growth and Partner-led accounts – is working. Though, we are fully aware that there are areas around consistency and execution that we can continue to improve. On the marketing front, we have made considerable progress to strengthen the image of CA's brand. There is strong evidence that our marketing programs are positively impacting consideration and accelerate our ability to build a demand pipeline for our products.

As you may have seen, we are engaged in a technology partnership with CNN in its coverage of the presidential election. CNN is leveraging our technology to enable a new app, 'CNN Politics,' built with CA API Management and CA Mobile App Analytics. This enhances CNN's ability to provide their audience with a rich and immersive election experience, enabling them to more directly engage in one of the biggest conversations of the year – in the U.S. and around the globe.

We are making strides in changing the trajectory of CA. There are things we are proud of with regard to our execution in FY16 – and there are areas where I know we can continue to improve. We are making progress, but as I've said before, progress is not linear. We will continue to manage the business with thoughtful discipline and continue to do what's in the best interest of our customers, employees and shareholders over the long-term.

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

Rich Beckert:

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 and fiscal year. The balance of our financial details can be found in our supplemental and press release.

Our Q4 total revenue was $1.01 billion dollars and was up 1%. Enterprise Solutions increased 6%, Mainframe Solutions declined 2%, and Services were flat. Fiscal 2016 total revenue was $4.03 billion, in-line with our guidance of down 1% to flat. Enterprise Solutions were up 2%, Mainframe was down 2%, and Services declined 3%.

Q4 renewals were down approximately 10% and down low teens as reported. As Mike stated, we realized a number of renewal transactions earlier in the fiscal year, leaving less to close in Q4. The year-over-year changes in our renewal bookings vary on a quarterly basis due to the timing and duration of large transactions. Q4 total new product and capacity sales were down high-single digits and approximately 10% as reported. The acquisitions of Rally and Xceedium contributed high single-digits to new sales in constant currency and as reported. In the quarter, free-standing Enterprise Solutions new sales increased mid-single digits and increased low-single digits as reported. Named and Partner-led business increased low-single digits in constant currency and declined low single-digits as reported.

Our Q4 new sales performance was impacted by the headwinds of a smaller renewal portfolio as well as considerably shorter contract duration than we have experienced in recent years. Weighted average subscription and maintenance duration in Q4 was 2.66 years, down from 3.76 years in Q3, and the lowest it's been in recent quarters. Shorter duration in the quarter was driven by the composition of the portfolio that was up for renewal. A shorter average duration has the impact of reducing the stated total value of bookings.

To reiterate Mike's earlier comments, our new sales performance also reflects our discipline and general unwillingness to close deals early in the absence of compelling metrics for the sake of any quarter or year, for that matter.

For the full year, total new sales were up low teens and organic new sales were up mid-single digits. As reported, total new sales were up mid-single digits and organic new sales were down low-single digits for the year. As Mike mentioned, this is the third year in a row of notable organic new sales improvement.

Fiscal 2016 renewals were up approximately 30%, and up mid-twenties as reported, in-line with our expectations. Excluding the large system integrator renewal that closed in Q2, renewals were up high-single digits and low-single digits as reported.

The renewal yield during the quarter was in the mid-90s. Taking the average of the four quarters in the year, the renewal yield was just above 90%.

We expect fiscal 2017 renewals to be up mid-single digits year-over-year as compared to fiscal 2016 in constant currency and as reported.

Turning to geographies, Q4 new sales were down across all of the regions. New sales in North America and EMEA, our two largest regions, were particularly impacted by the renewal portfolio during the quarter. However, for the full year, excluding the impact of currency, new sales were up in all of the geographies, with the exception of APJ.

As reported, new sales were up in North America and Latin America and down in EMEA and APJ.

Within our segments, Q4 Enterprise Solutions new product sales were down approximately 10% in constant currency and down low teens as reported. Areas such as API Management, Agile Central, PPM, and Release Automation contributed to new sales in the quarter. However, as we've discussed in the past, within Enterprise Solutions, there are products in our Enhance portfolio that are more mature and not growing but contribute to margin and cash flow. Acquisitions contributed high single-digits in the quarter.

FY16 Enterprise Solutions new product sales were up high-single digits in constant currency and up low-single digits as reported.   Excluding the acquisitions of Rally and Xceedium, Enterprise Solutions new sales in FY16 were down low-single digits in constant currency and down high-single digits as reported.

In our mainframe segment, Q4 mainframe new sales including new product and capacity were down low-single digits in constant currency, and down mid-single digits as reported, in-line with our renewal portfolio. Fiscal 2016 mainframe new sales including new product and capacity were up in the mid-twenties in constant currency, and up in the high-teens as reported. Overall, we expect our mainframe revenue to decline in the low single digits over the medium term, which we believe is in-line with the mainframe market.

Services revenue was flat in Q4 and declined 3% for the year. Over the longer-term, as our products become easier to install and we are able to better leverage partners, we expect that our services revenue will not experience the growth we anticipate from our software solutions.

Current revenue backlog was down 1% in constant currency, and was impacted by a lower renewal portfolio, as discussed earlier. Current revenue backlog will likely grow after we demonstrate multiple quarters of new sales growth, while maintaining a low 90's renewal yield.

Q4 non-GAAP operating margin was 38% and GAAP operating margin was 28%. Fiscal 2016 non-GAAP operating margin was 38% and GAAP operating margin was 28%. Fiscal 2016 segment operating margins were 10% for enterprise solutions, 61% for mainframe solutions, and 7% for services.

Our Q4 non-GAAP tax rate was 31% and our GAAP tax rate was 35%. Our Fiscal 2016 non-GAAP and GAAP tax rates were 29%.

Q4 non-GAAP diluted earnings per share was $0.60, up 21% year over year. Fiscal 2016 non-GAAP diluted earnings per share was $2.43, up 6% year over year. Q4 GAAP diluted earnings per share was $0.41, up 36%. Fiscal 2016 GAAP diluted earnings per share was $1.78, up 13%.

Our Q4 CFFO was $471 million, flat year over year. Single installment cash payments were $130 million and down year over year. Fiscal 2016 CFFO was $1.03 billion up 9% and above our guidance of 2%-7% year over year growth.

We ended Q4 with approximately $720 million in net cash. During the fourth quarter, we did not repurchase any shares, consistent with our plan following the accelerated share repurchase in the prior quarter. We paid $104 million in dividends. In fiscal 2016, we repurchased $707 million in shares and paid $429 million in dividends, which in total represents over 100% of our free cash flow. We expect to begin to execute against our existing $750 million share repurchase authorization through the course of fiscal 2017. At a minimum, we plan to offset dilution, and we maintain the flexibility to change pace opportunistically and due to market conditions.

Turning now to guidance. Guidance is based upon exchange rates on the last day of the preceding quarter, which was March 31st, 2016 and does not include the effect of any future material acquisitions.

Total revenue is expected to be flat to up 1% in constant currency. This translates to reported revenue of $4.04 billion to $4.08 billion.

We expect a full-year non-GAAP operating margin of 38 percent and full-year GAAP operating margin of 30 percent. Our GAAP and non-GAAP tax rate is expected to be between 28% and 29%.

Non-GAAP diluted earnings per share is expected to grow 1%-3% in constant currency. This translates to reported non-GAAP diluted earnings per share of $2.51 to $2.56. GAAP diluted earnings per share is expected to grow 3% to 6%. This translates to reported GAAP diluted earnings per share of $1.92 to $1.97.

At year end, we expect approximately 410 million shares outstanding, and a weighted average diluted share count of approximately 414 million shares. We expect the share count to be a few million shares higher sequentially in Q1 due to annual stock grants and then trend down through the course of the year.

Cash flow from operations is expected to increase 1% to 5% in constant currency. This translates to reported cash flow from operations of $1.06 billion to $1.10 billion.

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

Closing comments:

Thank you again for joining us this afternoon. I'd like to leave you with a few take-aways:

1) We delivered very solid FY16 results with most of our performance metrics coming in-line or above the high-end of our guidance
2) Q4 revenue was the first time the top-line has grown in nearly four years and we expect to cross into modest growth in FY17
3) We are making very good progress in our journey to drive long-term sustainable growth as we continue to manage the business with thoughtful discipline and do what's in the best interest of our customers, shareholders and employees over the long term.

Good night