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CA - Q3 2014 CA Technologies Earnings Conference Call

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OVERVIEW:

CA reported 3Q14 total revenues of $1.16b and GAAP diluted EPS of $0.51. Expects FY14 reported revenues to be $4.52-4.57b and reported GAAP diluted EPS to be $2.01-2.08.

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Richard Beckert *CA Inc - CFO*

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Walter Pritchard *Citigroup - Analyst*

Matt Hedberg *RBC Capital Markets - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for your patience. You've joined the CA Technologies third-quarter 2014 earnings conference call.

(Operator Instructions)

As a reminder, this conference may be recorded.

I would now like to turn the call over to your host, Mr. Jonathan Doros with Investor Relations. Sir, you may begin.

Jonathan Doros - *CA Inc - IR*

Thank you, and good afternoon, everyone. Welcome to CA Technologies' third-quarter Fiscal Year 2014 earnings call. Joining me today are Mike Gregoire, our Chief Executive Officer, and Richard Beckert, our Chief Financial Officer. Mike and Rich will offer some prepared remarks, and then we will open up the call for a Q&A session.

These prepared comments were previously recorded, and this conference call is being broadcast on Tuesday, January 21, over the telephone and the internet. The information shared in this call is effective as of today's date and will not be updated. All content is the property of CA Technologies and is protected by US and international copyright law, and may not be reproduced or transcribed in any way without the express written consent of CA Technologies. We consider your continued participation in this call as consent to our recording.

During this call, non-GAAP financial measures will be discussed. Reconciliations to the most directly comparable GAAP financial measures are included in our earnings release, which was filed on Form 8-K earlier today, as well as in our supplemental earnings materials, all of which are available on our website at ca.com/invest.

Today's discussion will include forward-looking statements subject to risks and uncertainties, and actual results could differ materially from these forward-looking statements. Please refer to our SEC filings for a detailed discussion of potential risks. Please note that our fourth-quarter quiet period begins at the close of business on March 14, 2014.

Before I turn the call over, I'd like to highlight that, for modeling purposes, our year-over-year currency headwind on revenue guidance is expected to be roughly 1 point for the full year. In addition, starting in the first quarter of Fiscal Year 2014, the measure of segment expenses and segment profit was revised to treat all costs of internal software development as segment expense in the periods the costs are incurred.

As a result, the Company adds back capitalized internal software costs and excludes the amortization of internally developed software costs previously capitalized from segment expenses. Prior-period segment expense and segment profit information have been revised to present segment profit and expense on a consistent basis. Also in fiscal 2014, the costs relating to the fiscal 2014 Board-approved rebalancing initiative announced in May, are excluded from the Company's segment expenses and segment profit.

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

Mike Gregoire - *CA Inc - CEO*

Good afternoon, and thanks for joining us.

We had a solid third quarter, driven by strong renewal business, disciplined cost control, and good progress towards our long-term goals. Third-quarter revenue outperformed expectations, and we are increasing the midpoint of full-year revenue guidance range once again. Non-GAAP operating margin during the third quarter was 39%. And we are raising our full-year non-GAAP operating margin guidance to 37% from 36%.

As you know from a separate press release we issued today, we have made a change in our executive team. George Fischer, Executive Vice President of Worldwide Sales and Service, is leaving CA Technologies after a 20-year career with the Company. Adam Elster, who has been running our Mainframe and Customer Success organization, will lead Worldwide Sales and Service, effective immediately.

I've had a chance to work closely with Adam for the past year. And I believe he will be an excellent sales leader, who will accelerate the transformation of our sales organization, reach new customers and drive growth.

He is ideally suited to this new role. He has run development teams, customer success and support, service and sales on a global basis. His business and operational skills are more important than ever as we move to a more operationally key service-oriented sales model. Adam also has a deep understanding of all aspects of our Company, and knows how to put them to work for our customers.

As I stated through my first year here at CA, we will need to nail the core fundamentals that make software companies great. To that end, we are focused on three primary goals: developing and delivering innovative products; increasing market and brand awareness; and accelerating our sales velocity.

The first goal is rooted in strong organic software development. But it also includes prudent acquisitions and the integration of products into solutions that help make our customers more competitive. Last quarter, we spoke about organic development and the launch of CA Nimsoft Monitor Snap, a feature-rich solution that is free for up to 30 devices. In 100 days since the product was introduced, 5,000 customers in 147 countries downloaded Nimsoft Monitor Snap. We are tracking well ahead of our goals for downloads, installations and pipeline generation.

Following on this success, we plan to expand the strategy of freemium and try and buy software to other CA product families, giving customers the opportunity to test our software and learn more about the value we deliver. We believe the proper use of these models will help us lower our cost of sales and sell more software to more customers.

Another example of organic software development is CA Cloud Storage for System z, which we launched during the quarter at the Amazon re:Invent Conference. This solution allows mainframe customers to safely, securely and efficiently back up their mainframe data to Amazon Web Services at a fraction of the cost of on-premise tape or disk. Cloud storage for System z is just one of many proof points of our continued commitment to the innovation on the mainframe platform.

While organic development over the next 12 to 24 months is at the heart of our innovation strategy, we need to increase investment in innovations and markets that will drive growth in three years and beyond. To that end, we are shifting more of our R&D spend to longer term investments that will provide us with the IP to be a technology leader in future years. Some of the spend is purely organic, with investments in areas such as mobility and analytics. But we are also beginning to make some external investments to help give us insight into new software technologies that fall within our addressable market.

During the third quarter, for example, we invested with venture capital firm IDG Ventures India to give CA early visibility into the many enterprise software startups in India. We're considering investing in other regions that offer similar ROI opportunities. We are making progress in recruiting the right talent and making the appropriate R&D investments to maintain and gain leadership positions in high-value areas of the IT stack, such as DevOps, identity management, mobility and analytics-based IT business management. Look for some key product announcements in February for both mobility and security.

A good example is the progress we're making in DevOps. As you know, we made two key acquisitions in the past couple years to take a leading position in this rapidly growing market; ITKO for service virtualization and Nolio for release automation. We've seen good growth from both products year to date.

One of the major customers is Lloyds Banking Group in the UK. I shared the stage at CA Expo in London last October with the bank's chief technology officer, who talked about Lloyd's success with our CA LISA solution. What started as a single project has grown into a multi-million dollar investment to standardize on our service virtualization solution throughout the enterprise.

Our service virtualization wins this quarter were spread across multiple industries, including newer verticals such as energy, manufacturing and healthcare. These are just a few of the many proof points that show customers are recognizing CA as the clear leader in DevOps, and are partnering with us to develop and deploy applications with greater speed and quality.

We also had a healthy renewal business in the third quarter, which is a testament to the value our customers place on their existing software investments with CA. This included a four-year deal worth more than $300 million with a large systems integrator, which included new sales of products, such as Nimsoft Monitor.

We added nearly 200 new logos during the quarter, bringing our total for the trailing 12 months to more than 580 new logos. And we saw strong performance from our two most recent acquisitions, Layer 7, which provides API management and security; and Nolio, which I mentioned earlier. We implemented a new integration framework and execution model to make sure we continue the market momentum in both of these highly innovative companies.

While I'm encouraged by our performance in Q3, our marketing and sales execution is still not consistent. This is evident in our mid-single digit decline in new product and capacity sales during the quarter. We also need more consistent positive performance in our international businesses. Our recent experience has been that some regions beat their plan one quarter and then come up short the next.

As a result of our performance so far this year, we currently expect our FY15 revenue growth rate and non-GAAP operating margin to be similar to what we are seeing in FY14. As you've heard me say before, one of the keys to driving sales in growth is world-class marketing. So we're putting a major focus on increasing our brand and market awareness, and this takes time. More IT buying decisions are being made by the business line and IT together, and they do a lot of research before they even reach a vendor. As a result, a strong brand is more important than ever.

The reality is, there is a significant gap between what the market thinks CA does and what we actually do. To close this gap, we're building a stronger, more contemporary CA brand, as well as a demand engine that will emphasize new customer acquisition.

If you were traveling recently, you might have seen the new CA at the Center banner ads at selected airports around the world. These ads feature testimonials from customers such as British Telecom, Rackspace Hosting and many others.

The British Telecom ad, for example, shows how BT employs our identity management solution to authenticate every consumer that accesses online content, such as British Premier Football. The Rackspace ad shows how the Company leverages the CA application performance monitoring to look to insure the up time of its 24 by 7 customer services. This is a multi-media campaign that targets senior IT and business decision makers not only with airport banners, but also with digital, social and mobile ads. You can find a link to a summary of our brand campaign on the Investors Relation web page.

Marketing also made a significant contribution to pipeline compared to last year, and drove a substantial year-over-year increase in lead volumes. That brings me to our third goal: accelerate our sales velocity, especially new sales. There is no silver bullet to new sales growth. But it's something that we need to get right to drive our long-term growth. Our success will come from strong, consistent execution across development, marketing and sales.

We are seeing some signs of improvement in our sales execution. During Q3, for example, we had an impressive multi-million dollar win with Energy Future Holdings, a new enterprise customer. The deal combined our security, service assurance and automation solutions to reduce risk and drive operational efficiencies. This transaction was highly competitive. We beat out IBM, Oracle and point solution vendors, and demonstrated the potential of CA when we understand our customers business challenges and leverage our differentiated IP.

As I've said before, building a sales model that will accelerate our growth is an evolutionary process. And I am confident Adam will provide the leadership we need to improve our execution and increase our sales velocity.

Our plan to improve sales execution has three key elements. First, we need to consistently execute strategic account planning in both our direct sales force and our partner sales force. Second, we have to increase our focus on new sales and expanding our customer base. We can't drive long-term growth unless we sell more products to new and existing customers. And third, we need to sell the value of our software without the reliance on a renewal.

A critical part of extending our customer reach and accelerating sales velocity, of course, is our partners. We have a thriving ecosystem of partners who have built great franchises around CA products, such as our products and portfolio management, identity management and mainframe solutions. During the quarter, CA signed an agreement with Northrop Grumman, a leading global security company and an IT solution provider, that will help Northrop Grumman expand its cloud-based services into healthcare, civil government and state and local markets. The company will use CA CloudMinder to provide customers with a secure, cost-effective identity and access management solution.

In addition, global systems integrators, including Wipro and Tech Mahendra, are building practices around CA LISA service virtualization for their customers. We're also strengthening the talent on our partner and alliances team. Earlier this month, we named Alyssa Fitzpatrick as our new leader of Global Alliances and Partners for CA. She joins us from McAfee, and brings leadership experience needed to execute programs that will grow our revenue and advance our long-term strategic position.

I am excited about the opportunity we have in front of us. We have laid the foundation for a great software Company through investments in organic engineering and the talented people that are fueling differentiated products. We are strengthening our brand and marketing. And we are improving our sales efforts to sell more software to more customers, directly and through partners. Now we need to accelerate the velocity of our execution.

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

Richard Beckert *- CA Inc - CFO*

Thank you, Mike. Before we get started with the quarter review, let me remind you that all comparisons are year over year and in constant currency unless otherwise indicated.

This afternoon I'm going to focus my comments on the key business drivers and performance indicators for the quarter. The balance of our financial details can be found in our supplemental and press release.

Q3 total revenue was $1.16 billion, down 2%. Mainframe grew 1%. Enterprise solutions declined 5%. And services declined 4%. On an as-reported basis, Q3 renewals were up approximately 50%, and include the impact from a four-year system integrator renewal. Excluding that large renewal, our Q3 renewals were up high-single digit as reported.

We continue to expect fiscal 2014 renewals as compared to fiscal 2013 to be up high-single digits as reported, excluding the large customer renewal that closed in Q3. As a result, we expect our Q4 renewals to be down year over year as reported. Our Q3 renewal yield was in the low 90s.

Within our Q3 results, total new product and capacity sales were down mid-single digits as reported. Our Q3 new product sales performance was mixed by region and customer segment. New sales associated with renewal opportunities performed well in both North America and Latin America. North America sales outside the renewals also performed well. However, overall, EMEA and APJ performance was below our expectations.

In our mainframe segment, capacity declined more than 15% as reported. And new product sales were down more than 20% as reported. Our new mainframe product sales and capacity growth can vary on a quarterly basis. We expect our mainframe revenue growth to be in-line with historical trends.

Enterprise solutions' new product sales were up low-single digits, primarily due to new sales attached to renewals and the performance of recently acquired products Layer 7 and Nolio. New service engagements were up 3% as reported.

From a balance sheet perspective, current revenue backlog was flat. This reflects a combination of our year-to-date sales performance, offset by a favorable year-over-year impact from a large system integrator renewal that is now entering our current backlog.

Q3 non-GAAP operating margin was 39%. Our segment operating margins were 62% for mainframe, 15% for enterprise solutions and 4% for services.

As Mike noted, we are raising our full-year non-GAAP operating margins to 37% from 36%. Please note that we expect typical Q4 seasonality in the Business, along with the full impact from many of the investments we have made in the last few months.

Turning to GAAP, our operating margin came in at 29%. Q3 non-GAAP diluted earnings per share was $0.84, up 33%. Remember, 26 points of growth are driven by the completion of the federal income tax exam.

GAAP diluted earnings per share was $0.51, down 7%. Our Q3 non-GAAP tax rate was 14%, reflecting the completion of examination of our federal income tax returns for the fiscal years 2005, 2006 and 2007. Our GAAP tax rate was 27%.

Our Q3 CFFO of $429 million was affected by the items we outlined during our investor presentation in May. Let me walk you through the year-over-year headwinds.

$73 million incremental cash taxes. This includes the current year impact of transitioning to a more balanced quarterly cash tax payment schedule. Fiscal 2014 rebalancing payment of $19 million. And a reduction in capitalized software development of approximately $40 million. Single installment cash payments were down slightly year over year. Current billings backlog was up 3%, and impacted by similar dynamics as our current revenue backlog. We ended Q3 with approximately $1.07 billion in net cash.

During the third quarter, we paid $113 million in dividends and repurchased more than 4 million shares for approximately $140 million. We are authorized to repurchase an additional $167 million of common stock, which is expected to be completed by the end of Fiscal 2014.

Turning to guidance. Updated guidance is based upon exchange rates on the last day of the proceeding quarter, which was December 31, 2013. This includes a partial hedge of operating income. Total revenue is now expected to be in a range of negative 2% to negative 1% in constant currency, an increase from our prior guidance of negative 3% to negative 2% in constant currency. This translates to reported revenue of $4.52 billion to $4.57 billion.

Non-GAAP diluted earnings per share growth is now expected to be in the range of 21% to 24% in constant currency, an increase from our prior guidance of positive 17% to positive 20% in constant currency. This translates to reported non-GAAP diluted earnings per share of $3.05 to $3.12. GAAP diluted earnings per share is expected to be in the range of negative 3% to flat in constant currency, an increase from our prior guidance of negative 7% to negative 4% in constant currency. This translates to reported GAAP diluted earnings per share of $2.01 to $2.08.

Cash flow from operations is expected to be in the range of negative 30% to negative 24% in constant currency. This translates to reported cash flow from operations of $960 million to $1.04 billion.

Guidance does not include the effect of any future material acquisitions. Underlining this guidance, we expect our GAAP and non-GAAP tax rate to be 14%. At the end of the year, we expect approximately 439 million shares outstanding and a weighted average diluted share count of approximately 448 million shares.

For modeling purposes, we would like to provide you our initial expectations for Fiscal Year 2015. Excluding the impact from the large customer renewal this quarter, we expect our Fiscal Year 2015 renewal portfolio to increase low- to mid-single digits compared to Fiscal Year 2014. As a result of our fiscal 2014 performance, we expect our fiscal 2015 revenue growth rate to be similar to fiscal 2014. We expect our fiscal 2015 non-GAAP operating margin to also be similar to fiscal 2014.

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

Jonathan Doros - *CA Inc - IR*

Thank you, Rich.

As the operator is polling for questions, I would like to inform you that CA Technologies is presenting at the Stifel Technology, Internet and Media Conference on February 11; the Raymond James Institutional Investor Conference on March 4. The Morgan Stanley Technology, Media and Telecom Conference on March 5; and participating in the Pacific Crest Emerging Technology DevOps panel on March 4. In the interest of time, please limit yourself to two questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

John DiFucci of JPMorgan.

John DiFucci - *JPMorgan Chase & Co. - Analyst*

Thank you. I have a question for Mike, and then a follow-up for Rich. Mike, you said that Nimsoft Monitor Snap -- it sounds like you're getting good momentum with the free downloads and the pipeline generation.

But are you yet -- because this is an experiment to look at, and now you're going to be doing it with some other products, too. Are you yet seeing traction as far as paid purchases of Nimsoft? Or is it still just too early to tell?

Mike Gregoire - *CA Inc - CEO*

No, John. It's a great question. We are seeing -- as they move through pipeline progression, we are in a state with less than 10 but more than 5 transactions where we're moving from free to some level of paid purchase. Or in the valuation where we're in the final stages of a selection.

John DiFucci - *JPMorgan Chase & Co. - Analyst*

Okay, great. And that's what's giving you confidence to apply this model more broadly?

Mike Gregoire - *CA Inc - CEO*

It's more than that. When I take a look at how technology buyers buy, by the time they're getting ready to purchase something, they've done a fair bit of research already by reading white papers, by going to company websites. It's just a progression of how people buy. And I think we have absolutely fantastic products. And if we can get them to touch and feel them, see how they work, see the crispness of the user interface, the ease-of-use, I think that puts us in a situation where we are more competitive, not less competitive.

So it's all in the evolution of what I think happens as people try to buy software. The more opportunities we have where a net buyer can really see the value with their own data set in their own environment, I think that puts us at a higher competitive advantage. We're definitely looking at that for Nimsoft Service Desk some time in the first half of this coming year.

And we're also doing something similar with our Perpetual products. If you want to do a try and buy with ITKO, we set up a lot of different proof of concepts. And I would say more than 20% and probably less than 50% of almost all of those purchases happened by the customer touching and feeling and seeing the application at work. And at least to spectacular results, we featured Lloyds in the press release here. That was a very small transaction, that's a mezzanine transaction that turned into a multi-million dollar standardized platform for a very well-respected, very technically savvy company.

John DiFucci - *JPMorgan Chase & Co. - Analyst*

Great. Thanks, Mike. And if I might, Rich -- and maybe, Mike, you might have some color on this, too. Rich, you said the Q4 renewal portfolio was going to be down year over year, I think (multiple speakers) --

What's that?

Jonathan Doros - *CA Inc - IR*

Our next question will go back to John.

Richard Beckert - *CA Inc - CFO*

John?

John DiFucci - *JPMorgan Chase & Co. - Analyst*

I'm sorry. Rich, you said that -- I believe you -- can you hear me, guys? Can you guys hear me? Can you hear me? Guys, can you hear me? I guess you can't. You know what? I'll --

Operator

Thank you. Walter Pritchard of Citi.

Walter Pritchard - *Citigroup - Analyst*

Hi. Can you hear me?

Jonathan Doros - *CA Inc - IR*

Can you hear us?

Operator

Yes, your line is open.

Walter Pritchard - *Citigroup - Analyst*

Hi. Great.

Maybe a question where John was going. Trying to get a sense of on the renewal side, first you had this large SI transaction in the quarter. I'm trying to get a sense of -- was that a transaction that was expected to close in Q3? Or is that a transaction that you expected to close some time next year, and it happened earlier?

Operator

Ladies and gentlemen, please remain on your line. We are experiencing technical difficulty. Please remain on your line for just a moment. And Mr. Pritchard, if you could hold your question for just a moment.

Once again, ladies and gentlemen, please stand by.

Ladies and gentlemen, please stand by. We are experiencing technical difficulty. Please remain at your lines.

Doros?

Jonathan Doros - *CA Inc - IR*

Yes.

Operator

Yes, sir. We are in the middle of a question from Mr. Pritchard. Mr. Pritchard, if you could proceed with your question, sir?

Walter Pritchard - *Citigroup - Analyst*

Can you hear me now?

Operator

Yes, sir.

Jonathan Doros - *CA Inc - IR*

Sorry Walter. We got disconnected. I apologize.

Walter Pritchard - *Citigroup - Analyst*

That's okay. Two questions. First, just related to the $300 million systems integrator contract that you signed in the quarter.

I'm wondering, was that a contract that you expected to close some time in 2015? Or was that a contract you had in your pipeline and was part of what you were thinking in terms of renewal portfolio this year?

Mike Gregoire - *CA Inc - CEO*

It was going to happen this year. It naturally would have expired in Q4. But the customer and us came to an agreement early. And that's a transaction that we're very happy with, that included net new product. It's a very powerful systems integrator that does an awful lot of work. And a lot of their product portfolio in the cloud is featured using our product. So that was a big win for us. And it also -- it's a big body of work to get a contract like that done. I'm very happy to have that done in Q3 so we can focus on some of the other larger contracts in Q4.

Walter Pritchard - *Citigroup - Analyst*

Mike or Rich, just related to the renewal portfolio, and you've given some preliminary guidance for fiscal 2015. Could you talk about what you're expecting in terms of the renewal portfolio for fiscal 2015? And when should we expect that the revenue and billings backlog starts to stabilize and maybe even go positive?

Richard Beckert - *CA Inc - CFO*

Okay. Hi. How are you? This is Rich. Excluding the large system integrator, we expect next year to be low- to mid-single digit growth for the renewal backlog.

And as you saw, currently the revenue backlog turned to zero this quarter. A little bit of a false positive because of the large system integrator. So it might bop down to the slightly negative, but as we continue to grow and expand, you'll see that pick up moving into next year.

Walter Pritchard - *Citigroup - Analyst*

Great, thank you very much.

Operator

Thank you, ladies and gentlemen.

(Operator Instructions) Matt Hedberg of RBC Capital Markets.

Matt Hedberg - *RBC Capital Markets - Analyst*

Yes, thanks, guys. Mike, in your prepared remarks it sounds like -- well, first of all we'll hear more updates from a product perspective in February. But I'm wondering what -- maybe you can give us some hints as to where you guys could go in analytics. That certainly remains top-of-mind for a lot of IT buyers we talk to.

Mike Gregoire - *CA Inc - CEO*

Sure. It's early days for us in analytics. But there's two projects we have ongoing right now. Both these products' projects are being run out of our Silicon Valley R&D center. One of them is taking a look at all of the log data that we have, primarily with our APM product and a lot of the IM and Nimsoft products. And looking for correlations into how to get to predictive down time, and help systems operations people predict and take corrective action earlier.

The other area is in our mobility application, which we're going to be launching in the back half of the calendar Q1. And there's a number of analytics that are built into that application.

But I'd like to take it to a higher level. And in the same way that every application, four or five years ago, stopped separating the application from the reporting. We're getting to that place with analytics. I think it's going to be very commonplace to have analytics built into just about every product, in the same way that you can't build a product without a highly useable user interface.

So this is technology and a platform and a methodology that we're feathering through all of our products. And I think it's going to be standard commonplace -- not just for us, but just about everybody in the industry.

Matt Hedberg - *RBC Capital Markets - Analyst*

That's great. And then, Rich, enterprise margins were impressive -- 15% this quarter. I guess a two-point question.

Can you remind us again longer term where you think enterprise margins could go? And second, should we expect a sequential decline into fourth quarter in that enterprise segment, similar to what we've seen in the last few years?

Richard Beckert - *CA Inc - CFO*

So a couple things. One, you have the historic Q4. You have more things coming due -- as an example, commissions. So that will put downward pressure on that. But you have to remember, the beginning of the year we removed $100 million worth of sales. And that will flow through going out over time.

So as we build out, we don't give guidance by individual piece parts. But as you'll recall, we said in a business as large as that, it should get into the high teens over time. It's just a question of when we get there. And that will be a balance between the top line growing and us becoming even more efficient as we go to market with all the things we laid out in this evolution that we're working.

Matt Hedberg - *RBC Capital Markets - Analyst*

That's great. Thanks, guys.

Operator

John DiFucci of JPMorgan.

John DiFucci - *JPMorgan Chase & Co. - Analyst*

Thank you. Can you hear me, guys?

Jonathan Doros - *CA Inc - IR*

Yes, sorry John.

John DiFucci - *JPMorgan Chase & Co. - Analyst*

Okay. Sorry about that. A question on the renewal portfolio. Rich, you said Q4 renewals, that renewal portfolio will be down year over year. So, I guess that will have a negative effect on the year-over-year bookings growth. If you can talk -- and Mike, if you have any color on this -- talk about your efforts of building that pipeline of deals outside the renewal cycle. Because that will, at least in the optics, will probably be more important next quarter.

Richard Beckert - *CA Inc - CFO*

Sure. So if you'll recall, in the beginning of the year, we moved the roughly 10% of the sales force from overlays into direct quota carriers. And they all went to non-ELA accounts. So as we move through that evolution, we will continue to see us build that out the rest of this year.

And it takes awhile for that relationship to start. And so as those relationships are happening -- in fact, North America had a pretty good quarter outside the renewal cycle this quarter. So what we need to see is that happen consistently in places like Europe in order for us to really move the needle year over year. And I don't know, Mike, if you'd add anything to that.

Mike Gregoire - *CA Inc - CEO*

Echo what Rick says. And other strategies we're putting in place. First of all, its been long time talking, but we're definitely doing -- separating the renewal from the going after net new accounts. When the same management structure is responsible for both, we hang around the renewal far too often. And you're seeing us evolve quarter by quarter, stripping that down.

Coupled with that, when I take a look at the total sales population and how many of those sales professionals carry direct quota, the ratio has got to go up. And we've done that already throughout the year. And once again, as we evolve, John, we are going to continue to do that. I want to have more sales professionals that have targeted accounts that are not necessarily based on the renewal, or they're separated from the renewal.

And then it just comes into sales hygiene. When we are selling and we have some of our net new products, we are demonstrating a lot more discipline from having those net new high-value products discounted at the same rate as some of our more mature value-oriented products. It's always frustrating to me -- and there's a telltale sign when we're doing a large renewal, and one of our value products just starts to show up in the sales cycle towards the end of our renewal period. And we're just being very disciplined that that product is not going to get stuffed into the renewal. There's too much value in there. And we have to show the value of that product so we can continue to invest in it.

These are the kinds of things that we've been working on each and every quarter, and we continue to evolve. And we're going to continue to do that all throughout 2015. With Adam on board -- and his background is a tight operator -- I think we're going to see pretty dramatic improvements into our sales efficiency and effectiveness. We have four models in our Company. We execute very well at one of them, which is enterprise licenses.

We have to sell SaaS. We have to sell all of our products to net new customers. And when you take a look at our partner ecosystem, I think there's work to be done to accelerate our partner ecosystem. So I'm very pumped up with some of the changes we're making in sales. I like an evolutionary approach, as you well know. But now is the time to start taking a look at multiple things happening at the same time, instead of single-threading some of our changes.

Jonathan Doros - *CA Inc - IR*

Next question please?

Operator

Aaron Schwartz of Jefferies.

Aaron Schwartz - *Jefferies & Company - Analyst*

Hi, good afternoon, thanks. I had a question on the large SI deal renewed in the quarter. I think you said that was a $300 million-plus deal over four years. And so if we just assume the best way to look at that is a straight line over the four years, in terms of what is added into the backlog numbers. If I make that assumption, it seems like current revenue backlog, excluding that deal, would have been flat sequentially September to December. Which I think is rare for you, given a seasonality. I usually see some growth there on an absolute dollar basis. If that is the right assumption for the treatment of that deal, can you just walk through what you're not seeing to increase that current revenue backlog in a seasonally stronger period?

Richard Beckert - *CA Inc - CFO*

Well, as we had said earlier, it did give you a slight false positive, which is what I'd said earlier. So you'll see that dip back down, which is really why the revenue backlog should really start to build in the first part of next year. We're actually quite happy with the renewal yield that we've been getting out of our renewals. You've seen its been in the low 90s all year. It's the first time we've had that consistently in the low 90s. And you see that benefit showing up in the subscription line.

So Aaron, I think we're on track, as far as how we're doing the renewals, as Mike talked about earlier. It's really getting us to sell outside the renewal cycle, and to consistently have our total new sales grow. In the quarter -- we were happy that ES did grow in the quarter, both with the renewals and standalone. But it was really driven primarily by the Americas, both North and South America. We need to see that hit around the world. And a lot of things that you just heard Mike talk about, is to drive just that.

Jonathan Doros - *CA Inc - IR*

Next question please, operator.

Operator

Phil Winslow of Credit Suisse.

Phil Winslow - *Credit Suisse - Analyst*

Thanks, guys. A question on the enterprise solution segment. We saw another -- at least in revenue -- a year-over-year decline there. And I understand there's obviously a big gap sometimes between rev rec and billings. But what do we need to see to start to turn that enterprise solutions line around and get that back to growth? And then I'll just have one quick follow-up to that.

Richard Beckert - *CA Inc - CFO*

As we had just said, we really need Europe predominantly to be able to sell consistently across the board. What we see is in certain quarters, particular countries do well. We don't tend to have them hitting on all cylinders. And even though they are participating very well in the renewals -- so the low 90s, they are sharing in that -- what we're not really getting is enough net new outside of the renewal cycles. So in a place like Asia, this quarter happened to have a lower renewal cycle. Then they show up with a lower overall growth rate.

So I think the things that we're currently working on to move quota carriers out into these other areas, we'll see that turn. A lot of the new products that Mike talked about earlier and that we'll announce over the next couple quarters also will drive that.

Mike Gregoire - *CA Inc - CEO*

Yes. And then, Phil, it comes down to basic blocking and tackling. There are things that, from an execution point of view, that I think we can do better at. It's one of the reasons why I want someone with a very strong operational background that knows how to run things of complexity, and will do that all day every day, is in the senior sales position.

Because I look at some of our account planning, and it's not nearly as sophisticated as it needs to be. We are a Company with a broad portfolio that competes with other companies with broad portfolios. But we also compete with single-point products. We have to field the right sales team at the right time, and we should know that before we engage. And some of those decisions need to be made quicker, they need to be made faster. Europe is a great example where we're probably not as crisp on that as we should be. And I think we can make some material improvements in how we execute across the board.

Jonathan Doros - *CA Inc - IR*

Next question please, operator.

Operator

Michael Turits of Raymond James.

Michael Turits - *Raymond James & Associates - Analyst*

Yes, strong quarter.

Questions first on the SI deal, and then on cash flow. So on the SI deal, just want to make sure we understand the structure, whether it's a standard structure where it's paid essentially at cash annually over the period and rev rec over the period. And make sure we understand the impact on the income statement this quarter. And then I have a question about cash flow.

Richard Beckert - *CA Inc - CFO*

Well, I think, Mike, I'll make sure I understand your question. It's a normal four-year transaction. The payments actually flow in a very even manner. So it's not up-front-loaded or anything like that. In fact, what I would tell you, that this deal closing one quarter earlier really didn't even impact the cash that we are expecting for the year. So that really is going to flow in a normal manner. It was all ratable revenue. So I hope I answered that question.

We were happy with the renewal we had, as Mike said. We were happy with the new product that went in with that, as well. All in all, it was a very good partnership between the two companies. We left, I think, that renewal with a stronger partnership than before we started that renewal process.

Michael Turits - *Raymond James & Associates - Analyst*

Yes, that's what I was looking for. And then on cash flow, two parts. One, you raised the guidance on the income statement, but not on cash flow this year.

And also, as I start to look into next year, on cash flow, there were a lot of unusual items in this year's fiscal 2014 cash flow. Can you just give us some idea of what the primary puts and takes are if we want to -- on this year -- if we wanted to try to look at next year on an apples-to-apples basis?

Richard Beckert - *CA Inc - CFO*

Sure. So if you were to normalize everything out so far, cash flow is roughly flat in Q3 and year to date. Just to remind people though, the cash flow headwinds for taxes is $178 million. And the rebalancing year to date is like $81 million. And as you recall, we have the capitalized software that you can see coming off, and that's another $80 million year to date.

So as those things either end because we will have finished our taxes through -- in fact we finished that piece of that in Q3 here. The rebalancing will go the rest of this year into part of the early half of next year. And then you'll have an ease and compare with the software cap. So that is a benefit, and you'll see the overall CFFO go up, year over year.

Now, that being said, we want to remind you though that, you know -- and it gets back really to the earlier question. Until we see our transactions outside the renewals happening on a consistent basis, we really want to be prudent. And with the way the economy is, we want to be prudent with how we talk about CFFO going forward. So we think we have struck a great balance. We're comfortable with the current guidance that we've given. And by design, the headlights we talked about for 2015, you'll hear what our guidance is in May.

Jonathan Doros - *CA Inc - IR*

Next question, operator.

Operator

Gregg Moskowitz of Cowen.

Gregg Moskowitz - *Cowen and Company - Analyst*

Thank you very much, guys. Both my questions have been asked.

I've just a question for Rich. Over the past two quarters, your operating margins have been trending around 40%. Just wondering if it's up to the incremental investments that are planned for fiscal 2015, with regard to your guidance for roughly 37% margins next year.

Thank you.

Richard Beckert - *CA Inc - CFO*

Right. So what we talked about for headlights -- remember, I'm going to give guidance in May. So the headlights we gave out to people, though, was really to talk about that you should expect the margins similar to our new margin that we just posted. And I think that really, hopefully, Gregg, was the question you're asking, right?

Gregg Moskowitz - *Cowen and Company - Analyst*

It is. And then, if I could ask a quick follow-up. If you could talk to what percentage, Rich, of your new logo bookings perhaps go into FFO as opposed to subscriptions?

Richard Beckert - *CA Inc - CFO*

I don't have that level of detail. But the way you should think about -- by definition, if its a new logo, they are normally going to be standalone transactions. They won't have had a ELA before because it's a new logo. So by definition, it will all flow there. Now, remember, inside of that FFO you have our entire SaaS portfolio, which is growing year over year and sequentially. So they both all fall into that category.

Over time -- and it might start as a few hundred thousand-dollar transactions -- when the bigger transaction shows up, that will no longer be viewed as a new logo. And at that time, you might start to introduce other products that maybe would go ratable. Was that helpful?

Operator

Mark Moerdler of Sanford Bernstein.

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

Thank you, I appreciate it. Most of my questions were asked.

One quick one. Mike, any sense on when do you think you'll start to see product sales on the enterprise side start to improve from all of the new products you bring into market? When it will be visible?

Mike Gregoire - *CA Inc - CEO*

Yes, sure. Well, we see it already in North America. And we had a very nice quarter in Latin America. And we have some issues outside of both -- in Asia and Europe, where we do a really good job at ELAs. The Company does that on a global basis better than any company I've ever seen.

It's just that the way that software is being built today and the relationships we have with customers are changing very rapidly. And I think that across the board, we consistently need to understand how to sell fast, how to sell net new products to net new customers, how to sell net new products to existing customers, and take advantage of our partner network. The partner networks have thousands of sales professionals all over the world that not only know how to take our software, but also add their own incremental value to it. And I think that we can do a lot more with those partners on a global basis.

So we are in a transitionary period of how customers buy, and the kinds of products and the way those products are delivered. And we just need to accelerate our own understanding of that, and get our marketing, get our products and our sales working together in concert all day, every day, where it's not so lumpy. I think we are well on our way. We understand what we have to do. We have to get to the work of doing it.

Now, once again, I like to take a very evolutionary approach to sales. What I don't want to do is disrupt the 500 large customers that we have that have significant operations with us. They like their sales professional that they deal with. I want to keep that as stable as possible. A lot of this has to do with moving to the new open white space. There are literally thousands of customers -- between 300 million and 2 billion -- that we don't deal with very well. We need to have marketing program in place. We need to have sales professionals that know how to hunt in that particular segment. And once again, we have to be very disciplined with our partners.

It's always a mistake when you have a direct CA salesperson and a partner at the same account. And I've got to tell you from experience, it happens far too often. We need to have our direct sales force in a place where nobody is. Or have our partners in a place where we're not. And try to sell more. Is that helpful, Mark?

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

That's very helpful, and I do appreciate it. One quick for Rich. How much of the cash is in the US at this point?

Richard Beckert - *CA Inc - CFO*

41%.

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

Excuse me?

Richard Beckert - *CA Inc - CFO*

41%.

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

41% is cash US. Perfect. Thank you. And thank you, Mike.

Jonathan Doros - *CA Inc - IR*

Next question, please.

Mike Gregoire - *CA Inc - CEO*

Thank you.

Operator

Kirk Matterne of Evercore Partners.

Kirk Materne - *Evercore Partners - Analyst*

Thanks very much. Mike, just to follow up on a point you're making about some of the smaller customers. Do you think -- I guess right now, the sales model -- do you have the requisite, say, telesales model in place to do things like a freemium model, if you want to experiment with that? If you saw some success with Nimsoft Snap, just for example, do you have the right go-to-market mix? Because that is a little bit of a different type of sales model than your traditional model. So if you saw success in that --

Mike Gregoire - *CA Inc - CEO*

I think you're 100% right on. We haven't, but we need to expand it. And that's part of the plan we have going forward, is getting the right amount of headcount into these kinds of techniques of getting higher quality leads with lower-cost sales engine. When you take a look at our total population in sales and how many of them carry direct quota, we still have some work to do there.

Kirk Materne - *Evercore Partners - Analyst*

And is that incremental?

Mike Gregoire - *CA Inc - CEO*

(multiple speakers) that responsive?

Kirk Materne - *Evercore Partners - Analyst*

Yes, I did. Thanks. And is that incremental expense when you think about your initial fiscal 2015 guidance? Or is that -- can you reposition a lot of what you have on board already?

Mike Gregoire - *CA Inc - CEO*

No, I think this is repositioning. When I take a look at across the board, some of these new techniques are getting lead generation. It costs a lot less than the way we currently do it. The way we currently do it today, I think, is very de-spoked, very expensive.

It's one of the reasons why we're so attracted to having Lauren come on board to run marketing, as she has built digital marketing channels before. And she's also brought in a number of people that she's worked within the past, so they are not learning on the job. This is all about experienced marketers that really understand digital, that can get information into our sales force automation system. And then have the right kind of sales professional go after the particular opportunity.

We are getting much better at doing that. I think our sales force is starting to understand the value of being able to do that, where they aren't wasting their time on sales campaigns that have low probability of close. So I think, across the board, I see traction on a global basis. And it just takes a little bit more time than most people would like, and we're going to be at this all FY15.

Richard Beckert - *CA Inc - CFO*

The only thing I would add to that, Kirk, we spent -- a lot of the money you hear us talking about was getting some of our systems up to speed so that we can now have a lot of these things track electronically. So that's a lot of the incremental investment that we did in the back half of the year to do everything Mike just said.

Kirk Materne - *Evercore Partners - Analyst*

Great, thanks. And Rich, just one quick follow-up for you. You mentioned on the renewal portfolio will be up low- to mid-single digits in 2015, if you excluded the large customer this quarter. If you are looking at it more on a reported basis, will that be up or is it down? I'm not trying to gauge the exact size, I'm just trying to get directionally, because as we build our models out.

Richard Beckert - *CA Inc - CFO*

I'm not sure I follow your question.

Kirk Materne - *Evercore Partners - Analyst*

Sorry. If you included the large customer, is it down year over year in fiscal 2015?

Richard Beckert - *CA Inc - CFO*

Correct.

Kirk Materne - *Evercore Partners - Analyst*

Okay, thanks.

Richard Beckert - *CA Inc - CFO*

But as you know, whenever we talk about the large system integrators, we always back those out of our discussions. As we showed back in last May, when we showed you the bar chart, we do that on purpose, because they are an anomaly.

Kirk Materne - *Evercore Partners - Analyst*

I got it. Thank you.

Jonathan Doros - *CA Inc - IR*

And we'll take our last question.

Operator

Abhey Lamba of Mizuho.

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

Thank you. Mike, in the past you've talked about plans to reduce or eliminate commissions on renewal contracts. What are your latest thoughts on that? And is that being contemplated for fiscal 2015 comp plans?

Mike Gregoire - *CA Inc - CEO*

Yes. We continuously look at how do we get the most amount of value, and pay and incent our workforce most appropriately. And the way we look at it, the more complex the transaction, the more you should get paid. The least complex the transaction, the least incentive dollars. So that's, philosophically, where our heads at.

You take a look at this renewal for the large system contractor. That was an extraordinarily well-run pursuit. It required great efforts from our legal team, great efforts from our finance team, great efforts from the sales and product team. And the quarterback behind that is in the sales management team. And they earned every cent that they get paid in commission on doing a transaction like that.

Now, if somebody is just trying to pick up nips on a renewal, that's not that exciting. And they should not get paid nearly as much as some of the more complex transactions. As we start looking through our sales force segmenting, taking a look at their talent base, what they're good at, what it is we need, what they want to do with their career, we're getting a lot more granular with respect to commissions. And I'm pretty happy with how we're looking at this.

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

Thanks. And very quickly, Mike, you've spent a lot of time in talking about sales outside of renewal cycles. Especially in Europe and Asia, where it seems like they seem to be lagging behind North America for a couple quarters now. Is that something market dynamics on those regions? Or do you think you need to make some senior management changes in those regions within your organization to move those regions ahead?

Mike Gregoire - *CA Inc - CEO*

You know, I think the leadership team we have there is more than capable of making the transition. I think it's a combination of understanding the market, getting the right product specialist in place, and then taking advantage of the digital marketing. So I think they well-understand what our expectations are. There's no shortage of effort.

And I think that with the support they're getting from the rest of the Company, and seeing how we're able to make these transactions happen in North America -- as you well know, too, enterprise software is a very reference-based business. Having these big reference accounts for sales outside the renewal help us on a global basis.

If you just take a look at the script I used today, I think we had no less than five or six customer testimonials. You can't walk into a major airport right now and not see a customer testimonial of CA and what we do for customers. All of that is going to be additive to helping some of our regions that are struggling a little bit, figuring out how to sell outside the renewal. But make no mistake about it, we are going to be able to sell outside the renewal. Make no mistake about that.

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

Thank you.

Mike Gregoire - *CA Inc - CEO*

So with that, I'd like to conclude, thank everyone for their time on a very snowy afternoon here in New York. We are continuing to make progress on our organic product delivery. I'm very happy with the product portfolio and what the team has been able to do over the last year. I think you're going to see that continue on going into Q4 and into FY15.

We are definitely making the right kind of evolutionary progress in sales. I'm very excited to have Adam on board and be able to work with him and try to move us further down the field with respect to what we're trying to get done in selling to some of these white spaces where we just don't have enough traction.

So with that, I'll let you go. We're going to have a really strong Q4, and do our best efforts to make sure that FY14 ends the way we want it to. Take care, and all the best.

Operator

Ladies and gentlemen, this does conclude your program. Thank you for your participation, and have a wonderful day. You may disconnect your lines at this time.