08-May-2018

CA, Inc. (CA)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the CA Technologies' Fourth Quarter and Full-Year 2018 Results Conference Call and Webcast. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, today's conference is being recorded.

I would like to introduce your host for today's conference, Ms. Traci Tsuchiguchi, SVP, Investor Relations and Strategic Finance. Ma'am, please go ahead.

Traci T. Tsuchiguchi
Vice President of Investor Relations, CA, Inc.

Thank you, and good afternoon, everyone. Welcome to CA Technologies' fourth 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 Tuesday, May 8, 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 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.

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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 10-K, for a detailed discussion of potential risks.

Please note that our first quarter quiet period begins at the close of business on June 22, 2018. 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.

Michael P. Gregoire

Chief Executive Officer & Director, CA, Inc.

Good afternoon and thank you for joining us.

In the fourth quarter, we delivered solid operating margin and strong CFFO growth. Our SaaS business continues to grow rapidly, and our stand-alone transactions in the quarter for both Enterprise Solutions and Mainframe group. New sales outperformed our renewal portfolio and we executed a number of key customer wins. Our renewal yield for the quarter was well above 90%.

Q4 Mainframe new sales grew considerably, and can be attributed to the combination of on-going innovation we are bringing to market as well as a robust Mainframe hardware cycle. Specifically, we continue to benefit from new innovations that are resonating with customers.

Our Mainframe Operational Intelligence solution, which addresses the engineering and technical skills gap by applying artificial intelligence and machine learning, continues to deliver strong results. And, Dynamic Capacity Intelligence, which helps customers to better manage costs by optimizing the MIPS capacity utilization, continues to do well.

In the quarter, our enterprise license agreements, or ELAs, had a significant increase in the attach rate of Mainframe products. We also saw a considerable uptick in stand-alone Mainframe business, or Mainframe new sales done outside of the renewal.

Within some of our combined Mainframe and Enterprise Solutions ELAs, our customers more heavily weighted their spend on the Mainframe platform relative to Enterprise Solutions on-premise spending with CA. As a result, the amount of Enterprise Solutions attached to contracts combined with Mainframe Solutions was at the lower end of what we typically experienced.

We believe this lower Enterprise Solution attach rate is a result of our strong suite of Mainframe Solutions and the strong Mainframe hardware cycle. This dynamic impacted our Enterprise Solutions new sales, which declined in the quarter. Though our stand-alone ES sales improved, we should have captured more. That said, both ES and organic ES revenue increased in the quarter.

Globally, security remains a critical concern to our customers, and CA is uniquely positioned in the identity space to help customers with hybrid cloud environments. In the fourth quarter, we saw a strong uptake in our recently launched Trusted Access Manager for Z, a solution for the Mainframe that is similar to Privileged Access Management, or PAM, in our Enterprise Solutions segment.

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Within Enterprise Solutions, our PAM solution delivered one of its best quarters with new sales growth of more than 50%. In the fourth quarter, we are also pleased to have been named a Leader in the 2018 Gartner Magic Quadrant for Identity Governance and Administration for the second consecutive year.

Customers like Comcast know that security mitigates risk and enables business. Comcast utilizes CA's security management solution ranging from PAM, APIM and Single Sign-On to simplify identity and access management, while also strengthening the governance and compliance by leveraging data from both its security and infrastructure platforms. This is a great example of how our product breadth solves customer problems in ways that point solutions cannot.

Product is the cornerstone of our strategy and a critical component of our efforts to achieve long-term sustainable growth. In Q4, CA was named a Leader in the Gartner Magic Quadrant for Application Performance Monitoring Suites. It is great to see industry recognition of our application performance monitoring, or APM business.

We are very proud of the solutions we provide that help customers solve complex enterprise problems. For example, the European telecom provider, Orange, has used CA APM to achieve the business outcome of reducing the time it takes to isolate the root cause of poor application response time or error by 40%.

In fiscal 2018, we achieved total revenue growth for the second consecutive year. Importantly, we did this while maintaining healthy operating margins and cash flow generation. For the full year, we delivered results that met or exceeded the guidance ranges we provided.

We continue to be pleased with the contributions of our acquisitions of Veracode and Automic. We are increasingly adopting a number of digitally-based go-to-market strategies that Veracode employs across CA. And we have seen dramatic acceleration in both Veracode's number of large transactions and its bookings growth. The critical need for automation and the business value it delivers resonates easily with customers, and the enthusiasm and passion for our automation platform is palpable.

Customers like luxury retailer Thomas Pink are using CA's Automic platform to automate manual checking and validation tasks, eliminate human delays and errors in processing file transfers, and reduce delivery time for management reports. This allows them to spend their time and resources on other ways in which to enhance their business outcomes.

The themes of automation, agility, insight and security are the core tenants of the value proposition CA is delivering to customers. Our ability to deliver these principal capabilities across platforms in a hybrid cloud environment differentiates us from all other independent software vendors.

The breadth and strength of our portfolio has never been better. It is a reflection of the great work our teams have done to build organically developed solutions and to acquire strategic assets that have dramatically enhanced the capabilities we deliver to customers.

At the same time, we are making customer experience a competitive advantage for CA. Our Net Promoter Score, an industry standard measure of customer loyalty, continues to rise along a positive trajectory and increased 6 points year-over-year in Q4. Importantly, our product quality and customer satisfaction continues to improve and more customers are considering CA a strategic partner.

As noted in the press release, Adam Elster has been an integral part of getting our sales organization to where it is today. We thank him for his many years of service and wish him well in his future endeavors.

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While we have made extraordinary progress on many fronts over the past several years, we are on a journey and are wholly committed to continuous improvement. I know that we need to move forward faster. To accelerate our progress, we expect to report a charge of approximately $140 million to $160 million in fiscal 2019. This will include the impact of executing against a real estate site consolidation strategy to move more of our people into our centers of excellence. The migration of our teams into fewer, larger locations supports our agile methodology.

This cross-business unit, cross-functional organizational alignment is required as we push with greater intention to shift more of our business to a subscription-based model. We know we need to enable our business to be more easily consumed this way. There is no doubt that more aggressively moving towards this delivery method across swaths of our portfolio can drive unparalleled value to our existing and prospective customers.

That said, we are in the early days and need to make adjustments to certain elements of our products, align our go-to-market resources and support functions to enable successful transition. As this unfolds, there will be employee implications as we look to transition a greater portion of our internal resources to better align with the skills and experiences required to drive our business forward. As such, in fiscal 2019, we expect to incur a charge that will also include the exit of approximately 800 employees.

These changes with regard to both site consolidation and the workforce will enable us to more heavily invest in specific areas within product development, increase investment in customer success, and employ a greater number of better aligned go-to-market resources.

For example, with the direct sales organization, we will more heavily invest in technical sales resources relative to generalists, and we plan to increase our digital sales footprint by 70%. We expect these changes will accelerate our transaction velocity and support our transition to more of a subscription-based model.

One of the areas where we've made tremendous progress over the last several years has been around re-defining, clearly articulating, and living our company's culture. This reflects our shared values and guiding principles in a way that we operate both internally and externally. While progress here is difficult to discretely quantify, I am incredibly proud that, for the third consecutive year, CA was named one of the World's Most Ethical Companies by Ethisphere Institute in 2018.

Looking back, while I'm pleased with the progress we've made as an organization, I'm even more excited about where we're going in the years ahead. As such, we plan to increase the rate and pace of our share repurchases this year.

With that, I'll turn it over to Kieran to review our fourth quarter and full-year results and guidance. Thank you.

Kieran J. McGrath

Executive Vice President & Chief Financial Officer, CA, Inc.

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.

In the fourth quarter, total new sales were up high-single digits as reported and mid-single digits in constant currency. From a geographic perspective, total new sales increased across all geographies in the quarter, except

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for Latin America, where new sales were down approximately 10% as reported and high-single digits in constant currency.

From a segment perspective, Mainframe Solutions new sales were particularly strong in the quarter and were up approximately 50% as reported and in a percentage in the mid-40s in constant currency. Our Mainframe new sales benefited from ongoing customer demand for our innovative solutions that help customers automate, optimize and secure their Mainframe operations, and from increased capacity sales driven by the strong Mainframe hardware cycle.

As Mike mentioned, this strength resulted in some of our customers spending more heavily on Mainframe Solutions this quarter. As a result, our Enterprise Solutions new sales were down mid-single digits as reported and high-single digits in constant currency.

Our renewal bookings were up high-single digits as reported and mid-single digits in constant currency, and our renewal yield was well above 90% in the quarter. For the full-year, total new sales were flat as reported and down low-single digits in constant currency.

Full-year Enterprise new sales were up low-single digits as reported and down low-single digits in constant currency, while Mainframe Solutions were down low-single digits, both as reported and in constant currency.

For the full-year, our renewal portfolio was down in the low-20s both as reported and in constant currency. Our renewal portfolio for the year was slightly below our expectations due to the timing of some transactions. Our average renewal yield was above 90%.

Total revenue for the fourth quarter was $1.08 billion, up 7% as reported and 4% in constant currency. Our acquisition of Veracode contributed roughly 4 points to total revenue growth in the quarter. Within our segments, Mainframe Solutions revenue was up 3% as reported and down 1% in constant currency, while Enterprise Solutions revenue was up 13% as reported and up 10% in constant currency. Services revenue was up 5% as reported and 1% in constant currency.

Total revenue for the full year was $4.24 billion, up 5% as reported and up 4% in constant currency. For the full year, our results included four quarters of inorganic benefit from our acquisition of Veracode, and three quarters of inorganic benefit from our acquisition of Automic, which was considered organic beginning in the fourth quarter. In total, our acquisitions contributed approximately 5 points to total revenue growth for the full year.

Full-year Mainframe Solutions revenue was approximately flat as reported and down 1% in constant currency, while Enterprise Solutions revenue was up 13% as reported and up 11% in constant currency. Services revenue was up 3% as reported and 2% in constant currency. Total revenue backlog decreased 1% as reported and 3% in constant currency, while current revenue backlog increased 4% as reported and 1% in constant currency.

For the fourth quarter, GAAP operating margin was 25%, and non-GAAP operating margin was 34%. Segment operating margins were 61% for Mainframe Solutions, 6% for Enterprise Solutions and 6% for Services.

Our GAAP and non-GAAP tax rates were approximately 15% and 25% in the fourth quarter, respectively. Our GAAP income tax expense included a $28 million tax benefit relating to the refinement of the provisional amount previously recorded for the impact from U.S. tax reform.

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GAAP diluted earnings per share was $0.49, up 29% as reported and 26% in constant currency. Q4 non-GAAP diluted earnings per share was $0.62, up 15% as reported and 17% in constant currency. For the full year, GAAP operating margin was 26% and our non-GAAP operating margin was 37%. Segment operating margins were 64% for Mainframe Solutions, 9% for Enterprise Solutions and 3% for Services.

Our GAAP and non-GAAP tax rates were approximately 53% and 25% for the full year, respectively. Our GAAP income tax expense included a $290 million charge related to U.S. tax reform. This charge was comprised of $194 million related to the deemed U.S. repatriation of earnings held by non-US subsidiaries, which is payable over eight years, and $96 million related to the re-measurement of deferred tax assets and liabilities for the change in income tax rates.

For the full year, GAAP diluted earnings per share was $1.13, down 39% as reported and 38% in constant currency. Non-GAAP diluted earnings per share for the year was $2.59, up 4% as reported and 6% in constant currency.

Fourth quarter CFFO was $548 million, up 30% as reported and 29% in constant currency. Single-installment cash collections were $176 million and were flat compared to the year-ago period. For the full year, CFFO was $1.20 billion, up 11% as reported and 8% in constant currency. CFFO exceeded our expectations primarily because of improved efficiencies and lower cash tax payments for the full year.

We ended the fourth quarter with $485 million in net cash. During the fourth quarter, we repurchased $20 million in shares and distributed $107 million in dividends to our shareholders. In fiscal year 2018, we repurchased $163 million in shares and paid $428 million in dividends. As of March 31, 2018, we have $487 million remaining of our original $750 million share repurchase authorization.

The following outlook for fiscal 2019 is based upon exchange rates on the last day of the preceding quarter, which was March 31, 2018, and is under the ASC 605 Revenue Standard. It assumes no material acquisitions, takes into account the costs and payments associated with the restructuring charge, and contains forward-looking statements.

As we implement the ASC 606 Revenue Standard for fiscal year 2019, we will be reporting results under both the ASC 605 and ASC 606 Revenue Standards during the fiscal year 2019, but will be providing guidance that primarily messages the business to ASC 605 results for comparability purposes.

As we push to sell a greater mix of our Enterprise Solutions as SaaS or subscription-based licenses, we anticipate seeing a near-term headwind to our reported revenue growth by approximately 1 point. In addition, we expect to successfully complete a long-term Services agreement resulting in the wind-down of a multi-year engagement with a government agency.

This, in combination with a growing portion of our business going ratable under ASC 605, impacts our expected revenue growth rates in fiscal 2019. As such, we expect total revenue for the full year to be approximately flat to up 1% as reported and down 1% to approximately flat in constant currency. This translates to reported revenue of $4.25 billion to $4.29 billion.

To accelerate our ability to align technical, field, and support resources with a cloud and subscription-based model, we expect to recognize a GAAP charge of approximately $140 million to $160 million. This charge contemplates the real estate site consolidation strategy that is well underway, as well as the exit of approximately

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800 employees through the course of fiscal year 2019. As aforementioned, we expect to reinvest the savings from these actions into areas within development, digital go-to-market initiatives, and customer success.

As a result, we expect our full-year GAAP operating margin to be between 24% to 26% and full-year non-GAAP operating margin of approximately 37%. We expect our GAAP and non-GAAP tax rate to be approximately 22%, which assumes no material refinements of the provisional amount previously recorded for the impact from U.S. tax reform.

GAAP diluted earnings per share is expected to increase 58% to 65% as reported and to increase 50% to 58% in constant currency. This translates to reported GAAP earnings per share of $1.78 to $1.87. Non-GAAP diluted earnings per share is expected to increase 6% to 8% as reported and to increase 2% to 4% in constant currency. This translates to reported non-GAAP earnings per share of $2.75 to $2.81.

At the end of the year, we expect approximately 406 million shares outstanding, and a weighted average diluted share count of approximately 412 million shares. As Mike mentioned, for fiscal year 2019, we expect to increase the rate and pace of our share repurchases. This reflects our optimism regarding the long-term value we expect to accrue to our shareholders and the benefit of U.S. tax reform.

Cash flow from operations is expected to be in a range of down 5% to down 1% as reported and down 7% to down 3% in constant currency. This translates to cash flow from operations of $1.14 billion to $1.18 billion. This includes the cash impact related to the restructuring charge, which is estimated to be in the range of $80 million to $100 million.

It also includes an estimated tax headwind of approximately $50 million compared to fiscal year 2018 due to the convergence of ASC 606 and U.S. tax reform. We estimate the impact of cash taxes in fiscal year 2019 to create an approximate 4-point headwind and the impact of restructuring to create a 6- to 8-point headwind to CFFO.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Raimo Lenschow with Barclays Capital. Your line is open. Please go ahead.

David Rainville
Analyst, Barclays Capital, Inc.

Q

Hey. This is David Rainville on for Raimo. Thanks for taking our question. So, maybe first one on the business and then a quick follow-up on cash flow guide, if that's okay.

In your prepared remarks, you mentioned that the strength in Mainframe drove lower Enterprise sales. How should we think about this? I mean, it seems quite unintuitive at first. So, any color on the puts and takes here would be quite helpful.

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.

A

Sure. We've put a lot of innovation into our Mainframe suite of products and we've put out three net new, completely organic products in the last 12 months. And that, coupled with the Mainframe hardware cycle, which has been very strong, you can see that in the results on the hardware line from IBM, had customers very focused on buying Mainframe MIPS to prepare for their future year as well as taking advantage of our solutions that handle everything from Mainframe Operational Intelligence to also managing their MIPS and helping them with the GDPR.

So I think what we've seen is, if they had $100 to spend, they are prioritizing their spend with CA on Mainframe Solutions, which I think had a short-term impact on the ES line.

David Rainville
Analyst, Barclays Capital, Inc.

Q

That makes sense. All right. Thanks for this. And maybe it would be great to get a little bit more specification around the cash flow guidance. I mean, there seems to be quite a lot of moving parts behind there. So, maybe a bit more specificity around the non-recurring items and what it would look like without those.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.

A

Sure. So this is Kieran. As we talked about before, our guidance overall is down in aggregate from down 7% to down 3%. But within that, we have about 4-point impact from cash taxes increasing. So we closed this year right around $350 million and we're modeling about $400 million next year.

If you recall, in prior quarters, we talked about the beneficial effect that we're going to get from tax reform as we go forward, as our tax rate falls to about a 28% to 29% range down into the low-20s. But offsetting that is, as we move to ASC 606 and there is an acceleration of revenue, especially as we clear out all of the license income that's on our deferred backlog and we recognize that in the beginning of this year, there's going to be a pretty large cash hit for that that we'll get to take over four years.

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You put those two together, all in, and what we see is about a 7-point hit next year from restructuring and about a 4-point hit from the net increase in the tax, so the tax benefit from tax reform and the tax hit from the move to ASC 606. And underneath that, we've also had some pretty significant operational improvement in the business. We do have some acquisition improvement on a year-on-year basis, as well as we're going to see a slight reduction in our interest expense as we move to next year.

David Rainville
Analyst, Barclays Capital, Inc.

Q

That's helpful. Thanks very much.

Operator: Thank you. And our next question comes from the line of John DiFucci with Jefferies. Your line is open. Please go ahead.

John DiFucci
Analyst, Jefferies LLC

Q

Thank you. I guess this is for both, Mike and Kieran. You say you're restructuring here to better align business fundamentals and you're also moving to more of a subscription model. I guess, there's two things that I just need a little clarification on.

One is, I guess, aren't you already a subscription model? I mean, wasn't CA like the pioneer in that in 1999? I think it was when you went through a subscription model one day and went from $4 billion [ph] in revenue (25:38) to $2 billion and then built up over time. A lot of confusion back then, but I think people understand the subscription model today. So I'm just trying to figure out what that means.

And then, I guess, to better align business fundamentals, the restructuring, that's still a little unclear as to what that means too?

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.

A

So, hey, John, it's Kieran. So, let me let me start with – so you're absolutely correct that CA had a Mainframe business that was by and large subscription, primarily subscription, and obviously taken on a ratable basis.

I think the big move that was discussed that you're asking about in the early 2000s was really towards moving the entire business to ratable and a lot of that, especially from an ES perspective, where the licensing model was primarily a perpetual licensing model, but because of the absence of VSOE, required us to take business ratably.

So, if you think about our business today, our Mainframe business by and large is a business that is subscription in nature. Our ES business though is by and large, with the exception of our SaaS businesses, the rest of the on-prem business is really perpetual modeling in nature, but because of the lack of VSOE, has been taken primarily as ratable.

So what we're trying to do now is to drive more, obviously, the SaaS businesses subscription and we're going to continue to grow that business, and that business has been growing quite healthy. So what we now look to do is take more of the on-prem business and actually move that to a subscription model as well. We see more of our customers are expressing an interest in actually acquiring that on more of a term or rental basis and really owning outright.

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Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.
A

And then, John, of how that gets done, we've fully embraced agile. And what agile means is, you need to be in the office, you need to be collaborating with each other. And we're taking a lot of our smaller satellite offices and reducing those footprints on a global basis and trying to get large groups of employees into bigger locations that are strategic. So, that hits the real estate side of the house.

But also we've gotten much, much better at developing software, which means that we don't need as many people with some of the skills that were for the legacy platforms. What we do need is skills for building SaaS. We need sales skills that understand how to sell to net new customers and, additionally, more technical sales that can sell to existing customers outside of the renewal.

So, when we take a look at what we're trying to do and make this move to a subscription model that is based on product, the only way to do that quickly is to go through a restructuring. And unfortunately, we're going to remove some 800 people from the company, but we're also going to be hiring somewhere between 500 to 600 people over the next year as well that will have different skills and more strategic geographic locations. And all of this is to drive growth and focus on our newer products and be able to ensure that we have the technical sales and the technical abilities to build these products.

John DiFucci
Analyst, Jefferies LLC
Q

Thank you. That's really helpful, Mike.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.
A

Right. So, John, what you're going to see is, obviously, the reduction in our facilities expense. A big piece of these head count reductions will be coming in the services and the sales area. And obviously, we'll always take a shot at going after G&A, and then reinvesting really in organic R&D in the fastest parts of our portfolio and remixing more of our sales resources into a digital sales and marketing model.

And from that perspective, we would expect that we're going to be more than doubling actually next year the amount of our digital sales resources.

John DiFucci
Analyst, Jefferies LLC
Q

And I guess, just one quick follow-up, I think, quick. Because I want to make sure, Kieran, when you talk about going, in the Enterprise Solutions, from the on-prem license plus maintenance model, perpetual model, to more of a subscription, are you actually referring to cloud based because that sounds like a huge change? Like, I mean, it doesn't happen that quickly.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.
A

[indiscernible] (30:09)

John DiFucci
Analyst, Jefferies LLC
Q

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Are you talking about a little of both? Go ahead. Sorry.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.

A

Yes. So, John, you're absolutely right. I mean, we have a SaaS business up next year. As we open up here in fiscal 2019, we'd be disclosing how much SaaS revenue we have and we'll see that.

But what we're discovering is, even within our on-prem business, there is a greater desire for customers to actually look at a he subscription model. We've had those offerings for quite some period of time, but Mike has said, you've heard Mike often say this, that the times where customer is going to pay upfront and to buy something outright in an environment where technology is changing so rapidly, little-by-little we're starting to see more and more of our customers asking for this model.

So, once again, we're trying to listen to our customers here and move more rapidly. Doesn't mean we're not going to have any on-prem sales. Many of our customers are going to want to buy with capital. They're going to want to own the licensing rights outright. But many of our other customers will want to enter into a model that allows them to have this on a rental basis, and we think that's going to be about 1 point of headwind against us in fiscal 2019.

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.

A

So, John, if you think of a couple of products that you'd be familiar with, like, for our Privileged Identity Management Solution, we can sell that license plus maintenance, but we have the ability to sell that as a subscription as well. What we're seeing is more and more customers given the choice who would prefer to buy that as a subscription. Similarly, with our APIM solution, it's an opportunity for us to get more customers be more attractive in the marketplace and be more competitive.

John DiFucci
Analyst, Jefferies LLC

Q

Okay, guys. That's really helpful. Thank you.

Operator: Thank you. And our next question comes from line of Sterling Auty with JPMorgan. Your line is open. Please go ahead.

Ugam Kamat
Analyst, JPMorgan India Pvt Ltd.

Q

Hey. Hi, guys. This is actually Ugam Kamat on for Sterling. Thanks for taking the question. So you guys mentioned that you would be reducing your head count by 800 this year and then hiring more like 500 to 600 people. So, just wondering in terms of the disruption that this would create, because most of the head count reduction is coming out of the customer-facing roles like sales. How have you baked that kind of disruption along with the departure of Adam in your guidance for FY 2019?

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.

A

Sure. First of all, out of the 500 to 600 people, I would say probably about 200 or so are coming from the customer-facing. But this is going to be net new head count, a lot of it doing digital sales which we currently don't

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do enough of today. When you think of customer acquisition and customer acquisition cost, the last thing in the world you want to do is have a direct sales person engaging with a customer for the first time.

The proper way to go about sales in a modern software company is to nurture those relationships digitally. And if you're doing it very well, the customers are going to have an opportunity to try and buy the software online. And then you're going to use your direct sales force to go past the land agreement into an adoption and expand, and once again, into a renewal. So, a lot of that head count is focusing on digital demand.

And, secondly, as we've built a lot of net new solutions that require a different skill set in selling, more hunters rather than farmers, you're going to see a more proliferation of attacking white space where we don't have relationships with customers. And then, we have a lot of customers, especially in the Fortune 500, that haven't had an opportunity to buy some of our newer solutions. And in order to do that, we need a more technical sales force that has the ability to not only sell, but demo the product.

This will help us in a number of different areas. First of all, get more customers, have more feet on the street. And when we put those feet on the street, they're going to be armed with better marketing and better digital support.

With respect to Adam, Adam has been a great contributor to our company. He's been personally a great help to me in transforming our sales organization away from just a renewal-only focus. But when you stop and pause where we are now and where we need to go forward, we are making a change. But, in doing that change, on the BU sales, there is no change. The same person that's running that business is going to continue to run that business and will report to me in the interim. I see no disruption there at all.

On the geo and the government work, it's going to report to another executive for the last 18 months has been running our global transformation strategy to get to digital and get to a more subscription-based business. And I expect him to spend about 80% of his time working with the sales force on how to do land, expand, adopt and renew deals. And he has the ability to do that because he's designing the work progress and all the systems for us and comes from the sales orientation background of the company, where he is an expert in our existing business model.

So, when it comes to doing renewals, there is nobody that knows how to do that or managing [ph] ELA (35:23) better than CA. I don't see any change in that. What I do see a change in is the acceleration of our ability to sell to net new customers and to be able to sell and move our products into our existing customers outside of a renewal. This is something we've been working on for the last couple years. I want to take a more intentional step forward in making that our priority going forward. So I see this as an opportunity to accelerate, not decelerate.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.

A

And I guess, just one other point to add, much of the sales resource that will be transitioning out of the business, very little of that, if any, are primary quota-carrying people. Really, it's more the overlay roles and support roles that are supporting that older business model that we've been working with for a long period of time, as we transition more into our higher velocity businesses.

Ugam Kamat
Analyst, JPMorgan India Pvt Ltd.

Q

Got you. That is really helpful. And just as a follow-up, you mentioned that, I mean, the cash tax increase from the ASC 606 is going to have a full 1 point headwind on your cash flow from operations growth. Just wanted to

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understand whether this is like a one-time expense that you would be getting in fiscal 2019 or, because of the like ongoing upfront recognition going ahead, is it like a continuing expense?

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.
A

Yeah. So, as we've mentioned in the past, this impact from ASC 606, we get the opportunity to actually pay it interest-free to the government over four years. So we would expect that that will be over the next four years.

Clearly, from a year-on-year perspective, we would expect this to be the first year of it having an impact versus another year. But we'll be paying that over four years and then, obviously, would be [ph] getting the benefit of (37:05) the ongoing cash flow benefits from the reduced tax rates overall to mitigate most of that. We think it's a net hit of about $15 million.

Ugam Kamat
Analyst, JPMorgan India Pvt Ltd.
Q

Perfect. Thank you, guys. Thank you so much.

Kieran J. McGrath
Executive Vice President & Chief Financial Officer, CA, Inc.
A

Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Kirk Materne with Evercore ISI. Your line is open. Please go ahead.

Fenn Hoffman
Analyst, Evercore ISI
Q

Hi. This is actually Fenn Hoffman on for Kirk. Thanks for taking the questions. Just to start, could you talk a little bit about sort of why now in terms of the reduction of the workforce? And are you looking to streamline the product portfolio at all as part of this announcement?

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.
A

So, why now? It's a beginning of a new year for us. When you take a look at our product portfolio, we have a number of products that are now SaaS-oriented and subscription-based. We'll be giving out guidance with respect to ARR sometime very soon, and you'll be able to see what that looks like from a progression point of view quarter-over-quarter. Obviously, you won't be able to compare it to last year because of the differences between ASC 605 and ASC 606.

And when we take a look at the ability to streamline our go-to-market and the investments we've made in digital, we have an opportunity here to put more primary quota-carriers and move away from support roles in the business than have paying multiple commissions for one deal. This is something we've been working on for an awful long time and we just felt now is the time to make these kinds of changes in a more dramatic fashion.

And secondly is, we have real estate that is underutilized and we want to focus our teams to be more together. If you are developing an agile, you're going to have designers, right beside sales professionals, right beside customers, besides programmers, DBAs, architects. And in order to do that, we need to get people into the office

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working closer together. So, in the last two years, we've been doing that and, in doing that, we've got a lot of satellite offices and excess real estate that is not being utilized. So, that was an opportunity for us to go ahead and clean some of that up.

Fenn Hoffman
Analyst, Evercore ISI

Q

Okay. Great. And just as a follow-up, does the increase buyback program indicate that you are not going to be as active as it relates to M&A?

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.

A

No, I don't think that is. We spend on average between $300 million to $500 million per year. As all of you know, the market's been a little frothy right now and we're still digesting two pretty big acquisitions. And so we are definitely still in the market looking for things that fit our strategy, but we are very disciplined buyers and we feel we have plenty of firepower to buy the kinds of things that the size that best suits our strategy and our ability to execute.

Fenn Hoffman
Analyst, Evercore ISI

Q

Okay. Great. Thanks.

Operator: Thank you. And I'm showing no further questions at this time. And I would like to turn the conference back over to Mike Gregoire for his closing remarks.

Michael P. Gregoire
Chief Executive Officer & Director, CA, Inc.

Great. Well, thanks again for this evening. In summary, we delivered strong earnings and cash flow growth in fiscal 2018. And excluding the non-recurring items, we are guiding for a strong CFFO growth for fiscal 2019. We are definitely accelerating our business transformation. We have a lot of confidence in the business to be able to do that, and we expect that to drive long-term shareholder returns.

Thanks, again, for your time. And I want to remind you that we're going to be having Analyst Day on May 30, if you have the opportunity to be there. We'd love to walk you through our product portfolio and a little deeper into some of our transformation activities. Thank you.

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

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