3Q18 Earnings Conference Call Script

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Thank you and good afternoon everyone. Welcome to CA Technologies' Third 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, January 30th, over the telephone and the Internet. The information shared in this call is effective as of today's date and will not be updated. All content is the property of CA Technologies and is protected by U.S. and international copyright law and may not be reproduced or transcribed in any way without the express written consent of CA Technologies. We consider your continued participation in this call as consent to our recording.

During this call, both GAAP and non-GAAP financial measures will be discussed.

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

Today's discussion will include forward-looking statements subject to risks and uncertainties, and actual results could differ materially from these forward-looking statements. Please refer to our SEC filings including our annual report on Form 10K for

a detailed discussion of potential risks. Please note that our fourth quarter quiet period begins at the close of business on March 15th, 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.

Mike Gregoire.

Good afternoon. Thank you for joining us.

I am very pleased to report strong fiscal third quarter results. Total revenue growth accelerated from the prior quarter, and organic revenue grew year-over-year. Quarterly revenue was the highest it's been in four years and resulted in the highest growth rate CA has delivered in 6 years. Importantly, we delivered a number of new, innovative products to the market.

In terms of bookings metrics, total new sales and organic new sales outperformed the year-over-year decline in the renewal portfolio.

Our strong revenue performance combined with disciplined expense management resulted in solid operating income and margin performance. Excluding the one-time impacts of the Tax Cut and Jobs Act that was enacted in the U.S. during our 3rd quarter – commonly referred to as U.S. Tax Reform - earnings per share grew year-over-year.

Across our portfolio, we are positioning CA as the preeminent partner for customers in building a Modern Software Factory. One that is agile, built to change, and able to adapt to market disruption and customer demand. Its foundation is in automation and it is fueled by data and analytics that are protected by strong security to preserve customers' most valuable assets. It enables customers to save time and money and

reduces errors so that they can deliver application experiences that delight their end users. This effort in building the Modern Software Factory is the combination of developing innovative organic products, acquiring strategic assets, and remaining focused on the customer journey and customer success.

In the third quarter, we launched a number of new products. They represent the on-going investments we are making across our portfolio and are great examples of the innovation CA is delivering to the market.

One of our newest organically developed products is CA Continuous Delivery Director, or CDD. This new SaaS based offering integrates the DevOps workflow for end-to-end visibility and management of application development, test, release, and monitoring. CDD applies intelligence to test planning and quality risk assessment. This enables developers to more easily assess pipeline progress and performance. It provides a seamless way to eliminate inefficient, spreadsheet-driven processes in release planning and management in a single pane of glass by orchestrating CA DevOps solutions, third party solutions, and Open Source technologies.

Another new product, CA BlazeMeter API Test is a lightweight SaaS-based testing solution that enables developers and testers of agile teams to auto-generate and execute hundreds of API tests concurrently. This is a great of example of a small acquisition that we made in FY17. Since the acquisition, we have ramped organic investment in the underlying technology and continue to expand its capabilities while knitting it into CA's broader DevOps and Continuous Testing set of solutions.

Globally, security continues to be a critical concern for our customers and CA is uniquely positioned in the identity space to help customers that have hybrid cloud environments. In the quarter, we launched CA Trusted Access Manager for Z – which is essentially Privileged Access Management for the mainframe. It eliminates the need for shared privileged credentials. And, it works directly with mainframe security best

practices, producing forensics on all privileged user activity so that customers can maintain complete control of sensitive, mission-critical data.

Our largest mainframe customers continue to experience MIPS growth. Often, they view mainframes as just another enterprise server within their hybrid cloud environment. As the second largest software supplier for this platform, and one of the only software companies making meaningful investments in the area, we are able to provide compelling and unrivaled solutions that address real business needs.

Our solutions are enabling customers to better manage storage needs while protecting the privacy of this data, helping them to achieve GDPR compliance. Our Dynamic Capacity Intelligence solution addresses the challenge of higher costs associated with increasing MIPS usage by optimizing capacity utilization. And, we're addressing the engineering and technical skills gap by increasingly adopting Artificial Intelligence and Machine Learning.

All of this innovation is helping to drive sustained, long-term renewal yields and healthy new sales in our Mainframe business. We continue to be very pleased with the performance of the Mainframe business unit. Our third quarter revenue performance was no exception. Clearly, we continue to invest in both our Enterprise Solutions and our Mainframe portfolios.

On the acquisition front, we continue to be pleased with the strategic nature of both Automic and Veracode. The integration of both acquisitions is progressing well and both are contributing to new sales and revenue growth. For example, the third quarter marked Veracode's largest bookings quarter in its history. Strength was driven by expanded opportunities influenced by CA's relationships. It also benefitted from broader geographic distribution. In the quarter, Veracode experienced robust growth internationally, where it had little distribution prior to the acquisition.

One of the core tenants of the fundamental improvement we've seen over the past few years has been our commitment to customer success. Our NPS – or Net Promoter Score – which is an industry standard measure of customer loyalty, continues to rise on a positive trajectory. In the quarter, our NPS improved 3 points from the year ago period. All underlying drivers of the score, including Product Quality, Product Functionality, and Ease of Use improved year-over-year. The percentage of customers who consider CA a "strategic partner" increased year-over-year. Our customer satisfaction score also improved over last year, with an average score exceeding 9 on a 10 point scale.

We are entering our fiscal fourth quarter with good momentum, which reinforces my confidence in achieving our full year revenue, margin and CFFO guidance.

In many ways, CA is a very different story today than it was several years ago. We plan to host an Analyst Day here in New York on May 30th, to provide a framework of what these changes mean as we look ahead to our FY19 and beyond. The timing of the analyst day will be shortly after we report our FY18 results and before we report our first quarter of FY19 results under the new revenue recognition accounting standard. It will be a great opportunity to refresh your perspective on CA and to better understand the way in which we will measure and judge our performance going forward. We look forward to sharing more then.

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

Kieran McGrath:

Thank you, Mike.

Before we get started with the quarter review, please note that all comparisons are year-over-year and as reported unless otherwise indicated. This afternoon I'm going to focus my comments on the key business drivers and performance indicators for the quarter. The balance of our financial details can be found in our supplemental and press release.

We were pleased by our results in the third quarter, which was driven by improved topline growth and ongoing disciplined expense management. Importantly, organic revenue grew on a year-over-year basis both in our Enterprise Solutions segment and for the Company overall.

Bookings

Total New Sales in the period were up high-single digits both as reported and in constant currency. Notably, we delivered strong new sales growth despite a renewal portfolio that was down in the high-teens as reported, and down approximately 20 percent in constant currency.

As we have stated previously, the year-over-year fluctuations in our renewal bookings vary on a quarterly basis due to the timing and duration of large transactions. Our renewal yield for the third quarter was in the mid-80s. Year-to-date, our average renewal yield is slightly above 90 percent.

From a geographic perspective, new sales increased in all geographies except in North America where new sales were approximately flat on a year-over-year basis.

From a segment perspective, Enterprise Solutions new sales were up in the mid-teens as reported and up low-teens in constant currency.

Mainframe new sales were down low-single digits, both as reported and in constant currency. Strong new product sales, driven by both established and newer products like Dynamic Capacity Intelligence, Data Content Discovery and Mainframe Operations Intelligence, were more than offset by lower capacity sales in the period, reflecting a smaller portfolio of renewals compared to the year ago period.

Revenue

Total revenue for the third quarter was $1.093 billion, up 9 percent as reported and up 7 percent in constant currency. Acquisitions contributed approximately 6.5 points to total revenue growth in the quarter.

From a segment perspective, Enterprise Solutions revenue was up 19 percent as reported and up 16 percent in constant currency. Mainframe Solutions revenue was up 1 percent as reported and was approximately flat in constant currency, slightly better than our longer-term expectation for the Mainframe market. Services revenue was up 11 percent as reported and up 9 percent in constant currency.

Total revenue backlog was up 1 percent as reported and down 2 percent in constant currency while current revenue backlog improved 8 percent as reported and 5 percent in constant currency. Approximately 5 points of the current backlog increase can be attributed to the acquisitions of Automic and Veracode.

Operating Margin and EPS

GAAP operating margin in the third quarter was 28 percent and Non-GAAP operating margin was 38 percent. Segment operating margins in the quarter were 64 percent for Mainframe Solutions, 11 percent for Enterprise Solutions, and 3 percent for Services.

In the third quarter, Mainframe segment margins benefitted from reduced corporate overhead, while ES segment margins benefitted from higher revenue and efficiency improvements. We believe that we will improve the margin of our Enterprise Solutions business over time. However, going forward, as our Enterprise Solutions revenue

becomes a larger portion of our overall product mix, we expect it to also absorb more of our corporate overhead which will partially offset the positive trends in our ES business.

GAAP and Non-GAAP income tax expense for the third quarter was $375 million and $71 million, respectively. GAAP income tax expense included a $318 million tax charge from the preliminary estimates resulting from U.S. Tax Reform. We have excluded these one-time charges from our Non-GAAP results. Of the $318 million, approximately $220 million related to the deemed repatriation of earnings held by our foreign subsidiaries, which is payable over 8 years, and approximately $98 million related to the re-measurement of deferred tax assets and liabilities for the change in income tax rates. We will continue to refine these estimates over subsequent periods.

As a result, our Q3 GAAP tax rate was 133 percent and our Non-GAAP tax rate was 18 percent. Currently, we expect our longer-term effective tax rate to be in the low-20 percent range, subject to further interpretation and clarification of U.S Tax Reform.

GAAP diluted earnings per share in the third quarter was a loss of $0.23, down 146 percent as reported and in constant currency. Non-GAAP diluted earnings per share was $0.75, up 19 percent as reported and up 16 percent in constant currency. Higher revenue coupled with solid operating margin drove our Non-GAAP EPS performance. Our Non-GAAP EPS also benefitted from an otherwise lower than anticipated effective tax rate. Specifically, net favorable discrete items benefitted our Non-GAAP results by approximately $0.04, and the lower statutory U.S. tax rate benefitted our non-GAAP results by an additional $0.05.

Cash Flow

Our Q3 CFFO was $315 million, down 39% as reported and down 41% in constant currency. The year-over-year decline in our CFFO is largely attributable to the timing of single-installment cash collections, which were $36 million in the quarter and down $195 million year-over-year. The timing of single-installments reflects a lower mix of bookings with financial services companies compared to the year-ago period.

We ended the third quarter with approximately $45 million in net cash. We paid $106 million in dividends and repurchased $53 million worth of shares outstanding in the quarter. We have $507 million remaining of our original $750 million share repurchase authorization.

ASC 606

We'd like to provide some incremental disclosure with regard to our upcoming adoption of ASC 606. We have not yet finalized our assessment as we still need to close our fiscal fourth quarter and there are a number of factors that will still need to be analyzed. That said, we currently believe that upon adoption of the new revenue recognition standard our total deferred revenue and revenue backlog will materially decline. As we mentioned last quarter, this reflects the license component of bookings recognized under the current standard. Under ASC 606, this will become part of a cumulative effect adjustment within retained earnings.

As a consequence of this adjustment, when taken together with certain U.S. Tax Reform provisions that accelerate the timing of US income recognition for accrual-method taxpayers, we currently expect an incremental impact of $100 to $150 million of cash taxes to be paid, on average, per year for the next four years.

We expect this cash tax impact will be largely offset by the benefit from the reduced U.S. corporate tax rate enacted under U.S. Tax Reform. Taken together, we believe the incremental cash taxes resulting from ASC 606 adoption and enactment of U.S. Tax Reform will be approximately $25 million to $50 million, on average, per year for the next four years.

As a reminder, we do not expect the new revenue recognition standard to significantly impact billings and cash collections from billings.

Guidance

Now, turning to guidance. Guidance is based upon exchange rates on the last day of the preceding quarter, which was December 31st, 2017. No material acquisitions are assumed in our guidance.

For the full year we continue to expect total revenue to increase by approximately 5% percent as reported and approximately 4% in constant currency. This translates to reported revenue of $4.22 to $4.25 billion.

We continue to expect our full year GAAP operating margin to be between 26 percent and 27 percent and our Non-GAAP operating margin to be between 36 percent and 37 percent.

Given the impact from U.S. Tax Reform, we now expect our GAAP tax rate to be in the range of 55% to 58%. Our Non-GAAP tax rate is anticipated to be approximately 25%. Our previous guidance was between 28% and 29% for both GAAP and Non-GAAP.

We expect our GAAP diluted earnings per share to decrease by 46% to 41%, both as reported and in constant currency. This translates to reported GAAP earnings per share of $1.00 to $1.10. The change to the GAAP diluted earnings per share outlook primarily relates to the change to the full-year GAAP effective tax rate as a result of U.S. Tax Reform.

We expect our Non-GAAP diluted earnings per share to increase by 2% to 5%, both as reported and in constant currency. This translates to reported Non-GAAP earnings per share of $2.54 to $2.60. The change to the Non-GAAP diluted earnings per share outlook primarily relates to the reduction in the statutory tax rate as a result of U.S. Tax Reform and other net discrete tax benefits realized.

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

We continue to expect cash flow from operations to be up 2% to 6% as reported, and flat to up 4% in constant currency. This translates to cash flow from operations of $1.10 billion to $1.15 billion.

With that, we'll take your questions.