by Cheryl Meyer

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Few companies have weathered and survived as many storms as **CA Inc.**, the software giant hindered by past and present problems.

Last year alone, it revamped its bungled sales organization, delayed financial filings and restatements, lost a handful of seasoned executives, reported disappointing financials and stock-options irregularities and deflected ongoing criticism of its board, CEO and management practices. Seven financial analysts have downgraded the company's sagging stock since July 2005. And it can't seem to shake its past: In November, Sanjay Kumar and Stephen Richards, the former CEO and head of sales, respectively, at the Islandia, N.Y., company, were sentenced to 19 years in prison collectively for securities fraud and obstruction of justice related to a $2.2 billion accounting scandal earlier in the decade. On Jan. 16, former CA general counsel Steven Woghin received a two-year prison sentence for similar charges in connection with the scheme.

All of this points in one realistic direction: CA now looks like a potential takeover target.

"Putting it as simply as possible, the safest way to salvage shareholder interests is to sell the operations to somebody who can establish a new culture," says Gary Lutin, an investment banker at **Lutin & Co.** and manager of an online public stockholder forum.

CA won't comment on a possible sale, but some sources say a private equity firm could come calling. The company has sticky customers and steady cash flow, largely due to a mainframe business that comprises about half of its revenue. That would make it a good fit for a buyout firm relying on incoming cash while helping right a company that for years has stumbled with management turnover, poor customer service, financial snags and too many products.

Fort Worth-based **Texas Pacific Group** and Menlo Park, Calif.-based **Silver Lake Partners**, two private equity firms experienced with technology buys, have surfaced as possible acquirers, and they've done deals together and with other firms for years. In 2000, they teamed up to buy disk-drive maker **Seagate Technology LLC** for more than $2 billion. In 2005, the two firms were part of the $11.3 billion buyout of storage company **SunGard Data Systems Inc.**, with heavy hitters **Kohlberg Kravis Roberts & Co.**, **Bain Capital LLC**, **Blackstone Group LP**, **Goldman Sachs Capital Partners** and **Providence Equity Partners Inc.** In early 2006, Silver Lake, along with KKR and **AlpInvest Partners NV**, closed a $10.6 billion purchase of **Royal Philips Electronics NV**'s semiconductor business. And in December the two buyout shops together paid $5 billion for travel technology firm **Sabre Holdings Corp.**, of Southlake, Texas.

Still, sources say CA could also attract strategic buyers, such as Redwood Shores, Calif.-based **Oracle Corp.**, which might benefit from CA's IT applications expertise, or rivals **IBM Corp.**, **BMC Software Inc.**, **Hewlett-Packard Co.** and even **Microsoft Corp.** Such pairings would be problematic: An IBM buyout might generate antitrust concerns, since both companies compete directly in the mainframe arena. "HP would also, in my opinion, raise some eyebrows, especially after the Mercury [Interactive Corp.] deal," says Brian Babineau, an analyst at **Enterprise Strategy Group**, an IT analyst firm in Milford, Mass. (HP acquired business software maker Mercury Interactive in November for $4.5 billion.) Oracle, meanwhile, operates in different markets than CA, so that combination should not trouble antitrust officials, sources say.

Whoever does the buying would have to pay a hefty price — at least a 15% premium to the company's stock, which currently trades at around $25, with a multiple of about 15 times cash flow. The company has a market capitalization of almost $13 billion.

CA downplays buyout speculation, touting instead its own acquisitions over the past two years in an attempt to spur growth in areas other than its mainframe business. Since late 2004, the company has bought 16 companies, most of them small to midsize, for a total of about $1.6 billion. Acquisitions include summer 2006 purchases of XOSoft Inc., a provider of application availability software, and MDY Group International Inc., a maker of enterprise record management software, both for undisclosed terms.

CA's associates

CA Inc.'s deals: 2004 - 2006

Date	Company	Business	Price ($mill.)
Sep 2006	Cendura	Change and configuration management software	*
Jul 2006	XOsoft Inc.	Application availability software	Less than $100
Jun 2006	MDY Group International Inc.	Enterprise records management software and services	*
Apr 2006	Cybermation Inc.	Job scheduling software	75[1]
Mar 2006	Proprietary software from Tevora Business Solutions Inc.	IT security products	*
Jan 2006	Wily Technology Inc.	Application peformance management software	375[1]
Jan 2006	Control F-1 Corp.	Problem management software	*
Oct 2005	iLumin Software Services Inc.	Enterprise management and archiving software	*
Aug 2005	Niku Corp.	Project portfolio management software	350[1]
Jul 2005	Qurb Inc.	Antispyware, security software	*
Jun 2005	Concord Communications Inc.	Network and service management software	350[2]
Jun 2005	Tiny Software	Firewall technology	*
Mar 2005	eTrust Cleanup	Identity and access management product from InfoSec Inc.	*
Nov 2004	Netegrity Inc.	Security software	430[1]
Aug 2004	PestPatrol Inc.	Anti-spyware software	*
Mar 2004	Miramar Systems Inc.	Desktop migration tools	*

*Undisclosed
[1] Cash
[2] Cash plus assumption of debt

Source: The Deal

The company has also won industry praise and recognition for its various products, including its IT governance tool, Clarity, which stemmed from its 2005 acquisition of Niku Corp., a provider of

IT governance software. In December, CA was voted as the best solution, best vendor and best presentation for its governance technology at **Gartner Inc.**'s Project & Portfolio Management Summit Europe.

"We firmly believe that today, with our acquisitions, we have the most relevant technology portfolio in our company's history," says Marc Stoll, a senior vice president of finance and head of mergers and acquisitions at CA. "We've been very happy with the technologies that we've got, and the prices we've paid have been very appropriate."

Stoll says CA is taking a step back and acquiring technology that will help it focus on integrating products, such as its September purchase of Cendura Corp., whose software maps how applications relate to one another.

The new focus has its critics. Bert Hochfeld, managing director of **Hochfeld Independent Research Group** in New York, says CA has often paid very high prices for companies and then integrated them poorly. What's more, he says, "They haven't been buying best of breed. They've been buying companies that, in my opinion, have been also-rans, or in dying spaces." He criticizes CA's purchases of security software maker Netegrity Inc.; Concord Communications Inc., a provider of business service management software; and Niku. He argues that CA should have considered buying Mercury, which HP snapped up.

"They need to buy somebody who has got demonstrably leading-edge technology," Hochfeld says. "They don't have that anywhere in their product line, and as a result, they've suffered."

Stoll says CA opted to buy the much smaller Wily Technology Inc. in January 2006 for $375 million in cash because Wily had expertise in the area of applications performance management, while Mercury's strength lies in applications testing, making Wily a better fit for CA's needs. "We're very disciplined on looking at our entire capital allocation strategy and how we're spending our shareholders' money," he says. "Bigger isn't always better."

Other analysts say CA has made smart acquisitions and paid fair prices but that continual internal troubles make securing and retaining new customers a difficult task. "The fact of the matter is nonmainframe customers still have to decide whether CA is a trusted vendor," Babineau says.

Kim Caughey, senior equity analyst and vice president at **Fort Pitt Capital Group Inc.**, a money management firm in Pittsburgh and CA shareholder, says her firm continues to hold shares because the product mix and technical track are good at the company. But she's still dismayed with the leadership direction. "We just need a sales force to get the word out there and execute," she says. "You don't really see the product capabilities marketed to get people in the door."

Last year, CA grappled with a huge sales commission problem, where it was effectively overpaying commissions to its sales force, costing the company $75 million more than expected. CA says it has recently restructured the company's sales force, simplified the sales commission plan and processes for managing it, aligned marketing resources behind key product launches and is more than doubling the number of customer-facing sales people, but analysts believe the company may still have trouble retaining and motivating key sales staff, especially those who came to CA via acquisition.

Down the road, CA faces a plethora of challenges: lackluster billings growth, some sales force disruption, continued accounting challenges, cost containment and lower cash flow in the near term. Last August, the company announced it would lay off 1,700 employees (300 through attrition), or about 10% of its head count. And the company revised fiscal 2007 guidance for cash flow from operations to a range of $900 million to $1 billion from a prior $1.3 billion target, a nearly 30% reduction, due to lower bookings expectations.

Last year, CA also announced a $2 billion share buyback. Financed with debt, the buyback is now half complete. The company is scheduled to announce its third-quarter fiscal year 2007 earnings on Feb. 1. In the second quarter of fiscal 2007 ended Sept. 30, CA generated cash flow from operations of $6 million, compared with $299 million in the same year-ago period — a 98% drop — largely due to its sales commission troubles, 401(k) plan contributions, restructuring payments and disappointing bookings, new CFO Nancy Cooper said during a conference call in November. So recently, CA's management put the buyback on hold while it evaluates its business and attempts to shore up cash flow and improve its performance.

That announcement raises a "serious question" as to whether a buyout firm could get the debt leverage necessary to acquire a company as large as CA at this time, says Ken Bender, managing director at **Software Equity Group LLC**, a San Diego boutique investment bank specializing in software.

Plus, CA's shares are more highly valued than its peer vendors, making it a difficult and risky acquisition for anyone, Hochfeld wrote in a November report.

"Given the abundance of cash available for buyouts and the growing competition among private equity firms, VCs and hedge funds for larger, highly leveraged deals, anything is possible," Bender says. "But in our view, most will not view CA as an attractive buyout candidate." He says with CA's enterprise value of $14.4 billion and shareholders likely commanding at least a 15% premium to its share price in the case of a buyout, resulting in a price tag of about $16.5 billion, private equity firms can find a much more attractive value elsewhere.

"**Symantec** [**Corp.**] and **Intuit** [**Inc.**] are both good examples," Bender says. "Given the current state of CA, even one of the more risk-oriented PE firms would be unlikely to place a bet that size on CA."

CA says it is in the midst of a "multiyear transformation" under CEO John Swainson, who has admitted he underestimated the time it would take to fix the company's problems.

"Swainson has run into many different issues I don't think he was aware of when he took the job," Babineau says of the CEO, who came aboard in 2004.

Still, analysts deem Swainson largely responsible for CA's latest tribulations, including the loss of some seasoned executives last year. In 2006, CA lost Jeff Clarke, the former chief operating officer; Mark Barrenechea, previous executive vice president and chief technology officer; Robert Davis, the company's former chief financial officer; veteran sales executives Gary Quinn and Greg Corgan; global marketing senior vice president Joan Blackwood; and a few other executives throughout the organization.

"The buck stops with John Swainson," FPC's Caughey says.

Despite the company's travails, revenue has risen on his watch.

In a Nov. 2 earnings call, Swainson, on the defensive in answering analyst questions, admitted CA didn't do as well in the first half of 2006 as it expected but that the company is diligently working out the kinks. "We're looking at every aspect of our operation and making changes to our critical business practices," he said.

The company's financial troubles run so deep that the independent examiner who is monitoring the company as part of a deferred prosecution agreement with federal authorities following the $2.2 billion accounting scandal, will now remain as late as May, CA reported in September.

Under the accord, which allowed CA as a company to avoid prosecution, CA agreed to pay $225 million in restitution to shareholders and agreed to oversight by a court-appointed monitor.

Some company watchdogs blame CA's problems on its board members, including former U.S. Sen. Alfonse D'Amato, who was a director during the accounting scandal and whom key investors and advisory firms have tried to remove. Its 11 board members were reinstated at CA's annual shareholder meeting in September, as was **KPMG LLP**, the company's independent auditor during that time.

"CA will continue to deteriorate until there's a change in control," Lutin says. "Whether that's replacing board members so that Swainson can be a more effective leader or whether it's selling the company is an open question, but it's not in the shareholders' interest to allow continuing deterioration."

Still others are more forgiving and patient, saying CA, despite all its troubles, can weather yet another storm, particularly since the company is still generating close to $1 billion in cash this year and its financials are self-sustaining.

"At the end of the day, CA is a large ship and therefore not really able to turn on a dime, whether it be strategically, operationally or financially," says Gregg Moskowitz, senior research analyst at **Susquehanna Financial Group LLLP** in New York. "So all of this will take time."