

BMC Software
Fourth Quarter Fiscal 2008
Conference Call
Prepared Comments

Derrick Vializ:

Good afternoon everyone,

I'm Derrick Vializ, vice president of Investor Relations, and I would like to thank you for joining us today. During our call, Bob Beauchamp, our CEO, will provide an overview of our fourth quarter performance; an update on our Business Service Management strategy and an update on our mainframe business. After that, Steve Solcher, our CFO, will provide additional financial and operational details. Bob will then provide our expectations for fiscal 2009 before we open the call to questions.

The prepared comments were previously recorded. This call is being web cast and a complete record of the call will be made and posted to our website. In addition to today's earnings press release, we have posted a presentation which we will refer to at various times during the call. Both of these documents are available on our investor relations website at bmc.com/investors.

Before we continue, I would like to remind you that statements in this discussion, including statements made during the question and answer

session, regarding BMC's future financial and operating results, the development of and demand for BMC's products, BMC's operating strategies, acquisitions, and other statements that are not statements of historical fact are considered forward looking statements.

These statements are subject to numerous important factors, risks, and uncertainties which could cause actual results to differ from the results implied by these or any other forward looking statements. Cautionary statements relative to these forward looking statements and BMC's operating results are described in today's Earnings Press Release and the financial presentation and in our Annual Report on Form 10-K. All of these documents are available on our website. These forward-looking statements are made as of today based on certain expectations, and we undertake no obligation to update these forward-looking statements.

I would also like to point out that the Company's use of non-GAAP financial measures is explained in today's earnings press release and a full reconciliation between each non-GAAP measure and the corresponding GAAP measure is provided in the tables accompanying the press release and in our GAAP to non-GAAP reconciliations found on our website at bmc.com/investors.

At this time I will turn the call over to Bob.

Robert Beauchamp:

Thanks, Derrick.

Good afternoon and thank you for joining our call.

In fiscal 2008, BMC Software had another terrific year across every metric of our business. Bookings, revenue, earnings and cash flow from operations demonstrated strong growth and were above all of our original target ranges.

In fact, in fiscal 2008 BMC Software set an all time high for total revenues at \$1.73 billion.

I'm very proud of these results...I'm proud of the strength and the consistency of performance that our team continues to deliver. We see this reflected in how we're building strategic relationships with customers...in how we're continuing to innovate...in how our sales team is converting mindshare into market share and...in how we're operating more efficiently. We're making real strides in every area of our business, and our 2008 fiscal year was another milestone in our progression.

Besides that record revenue number I noted, we've got other strong results to report for the year.

Total bookings and annualized bookings for the year increased 6 percent and 16 percent respectively. For the second year in a row, our non-GAAP operating income for the year increased by 40 percent. Our non-GAAP operating margin has increased by 6 percentage points in each of the last two

years. Non-GAAP diluted net earnings per share for the year increased 35 percent to \$2.00. And our full year cash flow from operations was \$594 million, which represents the highest level in the past five years.

Specifically looking at the fourth quarter, we can also see the progress we're making across the board.

- Core BSM license bookings were up 16 percent for the fourth quarter.
- Total revenue in the quarter increased significantly, by 11 percent, with growth in all major geographies. This represents the second straight quarter of double digit revenue growth.
- Our non-GAAP operating margin was 29 percent for the quarter, 8 percentage points over the prior year.
- The fourth quarter marked the twelfth consecutive quarter in which we've met or exceeded our revenue and non-GAAP EPS guidance.
- Non-GAAP diluted EPS for the quarter was 63 cents, up 58 percent compared to the year ago period.

Our record of bookings growth reflects the strong demand in the market for our solutions. BSM has now become main stream, and we continued to strengthen our leadership position in this rapidly growing space. More and

more enterprises are adopting our solutions as they seek to automate, align and standardize their IT operations.

Industry experts have long noted the importance of aligning IT operations with business priorities. Increasingly, businesses looking to pare back costs, increase efficiencies, and make their operations more nimble, find BSM to be a powerful ally.

To help our customers achieve these goals, we've adopted three disciplines, which you heard us describe at our Investor Day conference in March:

- Our **Service Support** offerings improve customer services as perceived by the end users and help drive efficiency improvements,
- Next, our **Service Assurance** offerings help customers find, prioritize and fix issues before they can impact their business, and
- Finally, our **Service Automation** offerings help IT support rapidly changing business needs, especially through the automation of provisioning and compliance-related functions and processes across servers, networks and clients. We were the first to automate the delivery of complete services, not just technology components.

A look at the BSM marketplace today shows that not one of our competitors are even close to delivering this complete range of capabilities; and no one can offer them through a platform such as BMC Atrium. BMC Atrium –

built on a next-generation architecture – provides a shared view of how IT supports business priorities as well as centralizes coordination and execution of IT processes. Our architecture provides customers with a completely unified and integrated management view – which fundamentally differentiates us in the marketplace. It's clear that this is a primary reason so many customers have chosen to standardize on our platform, and we're confident this approach will be an asset to us going forward.

Furthermore, a strategic trend we've noticed in the marketplace is that customers are gravitating towards a strategic management platform focused around Business Service Management, where previously they may have made tactical decisions around particular point solutions. Given our clear position as leader in BSM, this is a change we welcome, and something that's clearly evident in some of our recent sales wins.

Take for example Bank of New York Mellon, one of the nation's premier financial-services firms. We've had a long-standing relationship with the firm; as our solutions have broadened, we've been able to become a strategic partner. Given the breadth of our BSM portfolio, our strong track record in delivering quick time-to-value, and compelling market momentum, Bank of New York Mellon has chosen to standardize on our BSM platform, replacing a competitor's system with our superior suite of solutions.

We see that many of our other clients are beginning to look at us in the same way. Indeed, it's been a busy quarter for our ESM unit, as we've collaborated on BSM projects with firms such as State Street Bank and Trust, Italy's ENEL, and Sweden's global icon IKEA. Like Bank of New York Mellon,

IKEA has also standardized on our complete BSM platform and replaced a long-standing competitor.

Let me change direction for a moment to emphasize what's going on in Service Automation. It's no secret that IT costs are skyrocketing. Today, it is far more expensive to manage computing infrastructure than it is to buy that infrastructure. Businesses have tried to keep these management costs in check through outsourcing and offshoring. But even after these options are tapped, companies still face inefficient and brittle IT processes. Automation represents a significant opportunity for businesses to rein in IT spending while still meeting the reliability and responsiveness requirements of the business.

We recently completed the acquisition of BladeLogic, the leading and fastest growing data center automation company. By combining BMC's BSM platform with BladeLogic's data center automation solutions, we are clearly the new market leader in IT Service Automation.

This is a landmark acquisition for BMC and the industry. BladeLogic's automation solutions are complementary to our other BSM and Service Automation offerings; as a result, BMC is now able to offer the most complete spectrum of BSM tools on the market today. Furthermore, BMC and BladeLogic's solution portfolios are already integrated, and many customers have embraced the combined solution. And we're also pleased to report that members of BladeLogic's impressive senior management team agree with the opportunity as we see it and have decided to join BMC's executive ranks, something that will enhance the future potential of our

company. We are confident that the BladeLogic acquisition will provide an additional growth engine for top-line bookings and revenue in fiscal 2009 and well beyond.

Turning now to our MSM unit, we are pleased to report that the mainframe market continues to be healthy. In fact, the mainframe market is experiencing something of a renaissance. More web applications are tied into the mainframe, data volumes are exploding, and distributed work is making its way onto the mainframe. Of the many reasons behind this trend, three stand out: mainframe capacity scales well, switching costs to move off of the mainframe are high, and customers rely on their high performance and availability. Indeed, what we are seeing is a tapering off of customer migration to distributed systems. Most businesses that have chosen to move off of the mainframe have already done so.

We expect that the size of the mainframe software marketplace will be flat to slightly growing in the near term, and our innovative solutions have helped us generate bookings growth in this key area. Looking forward, we expect continued stability in our bookings trends, as well as annualized bookings growth, and increasing customer run rates. In this way, we'll be able to get the most out of this mature market by maintaining our share, margins and cash flow.

There's no question that BMC ended fiscal 2008 in a strong position. We're offering the right technology in the right place at the right time, and combined with our strong and improving management, we have achieved accelerated growth.

- Our ESM unit has been energized by its tighter focus on Service Support, Assurance, and Automation, and looks to accelerate growth in bookings and revenue in fiscal 2009;
- Our MSM unit is capitalizing on the continued stabilization of the Mainframe market and is geared toward optimizing profitability and cash flow; and
- Our focus and discipline in how we run the business will continue to yield greater business process efficiencies.

Given the strength of our business model, the breadth of our product portfolio, and our ability to execute, we're excited about fiscal 2009 and beyond. We're now very well positioned for long-term growth.

We'll talk more about our outlook for fiscal 2009 later on in the call. But let me first turn the call over to Steve Solcher, who will provide more insight into our financial results.

Steve Solcher:

Thanks Bob.

The fourth quarter and fiscal 2008 demonstrated solid financial results. All of our key metrics: bookings, revenue, non-GAAP operating margin, non-GAAP EPS and cash flow from operations improved significantly.

Throughout the year, we've gained customer acceptance of our solutions, maintained our cost discipline, and optimized our capital structure.

Operating Income and EPS

With that, let me start off by reviewing our financial results for the quarter and fiscal year.

Non-GAAP operating income increased by 53 percent, from \$90 million to \$137 million in the fourth quarter. Our fourth quarter non-GAAP operating margin was 29 percent up from 21 percent in the year-ago quarter. For the full year, non-GAAP operating income increased by 40 percent to \$485 million. Non-GAAP operating margin for fiscal 2008 was 28 percent, up 6 percentage points from fiscal 2007.

Non-GAAP net earnings for the fourth quarter were \$123 million, an increase of 47 percent over fiscal 2007. Non-GAAP diluted EPS for the period was 63 cents, up 58 percent compared to the year ago period. This

reflects a non-GAAP effective tax rate for the quarter of 21 percent, which included a favorable impact associated with guidance issued by a taxing authority in the fourth quarter related to certain deductions that the Company is entitled to.

For fiscal year 2008, non-GAAP net earnings were \$400 million compared to \$312 million in fiscal 2007. This represents an increase of 28 percent. Non-GAAP diluted EPS for the year was \$2.00, up 35 percent compared to \$1.48 in the prior year. This reflects a non-GAAP effective tax rate for the fiscal year 2008 of 29 percent.

These non-GAAP results reflect diluted shares outstanding in the fourth quarter and full year of 195 million and 200 million, respectively, versus 208 million and 210 million in the respective year ago periods.

GAAP operating income in the fourth quarter was \$98 million, compared with \$55 million in the year-ago period. GAAP net income and fully diluted EPS were \$97 million and 50 cents, compared to \$63 million and 30 cents in the fourth quarter of fiscal 2007, respectively.

Bookings

Turning now to bookings, total bookings for fiscal 2008 were \$1.78 billion, up \$101 million, or 6 percent compared to fiscal 2007. The weighted average contract length for total bookings for fiscal 2008 was 2.2 years, down from 2.4 years in fiscal 2007.

Total bookings adjusted for contract length resulted in annualized bookings for fiscal 2008 of \$816 million, a 16 percent increase over last year. This is now the ninth consecutive quarter in which we've achieved annualized bookings growth on a trailing twelve month basis. Please refer to slide 7 in our presentation.

Total bookings for the fourth quarter were \$552 million, representing a decline of 2 percent compared to the year-ago period. Despite a tough comparison to the prior year, annualized bookings for the fourth quarter increased 19 percent.

Now let me turn to the performance of each of our business units.

In the fourth quarter, total ESM bookings – which include professional services – were \$327 million, up 8 percent. Total ESM bookings for fiscal 2008 were \$1.05 billion, up 9 percent.

Total ESM license bookings in the fourth quarter were \$115 million, up 1 percent over the year-ago period. For fiscal 2008, ESM license bookings were \$387 million, an 8 percent increase over fiscal 2007.

Within our ESM business unit, growth of core BSM license bookings is a key indicator of the success of our Business Service Management strategy. Core BSM license bookings were up 16 percent in the fourth quarter, marking the eighth consecutive quarter of double-digit growth. For fiscal 2008, core BSM license bookings rose 13 percent. Please see slide 8 of our presentation of historical license bookings growth.

Turning to the MSM business unit, we believe MSM is best evaluated on the basis of total and annualized bookings over the trailing twelve months.

In the fourth quarter, total MSM bookings on a trailing twelve month basis increased 2 percent to \$731 million with an average contract length of 2.9 years. In the year ago period, total MSM bookings were \$718 million with an average contract length of 3.2 years.

After normalizing for contract length, total annualized MSM bookings for the trailing 12 months were up 13 percent to \$253 million.

Revenue

Turning to revenue: total revenue for the quarter was \$467 million, an 11 percent increase compared to the fourth quarter of fiscal 2007. This was above the high-end of our guidance for the quarter and the second quarter in a row with double-digit total revenue growth.

License revenue in the fourth quarter was \$189 million, an increase of 14 percent compared to a year ago.

During the quarter, the percentage of license bookings that were deferred was 48 percent – in line with the third quarter and eight percentage points lower than the year-ago period when the ratable rate for license bookings was at a historical high.

For the fourth quarter, maintenance revenue was \$245 million, an increase of 7 percent compared to a year ago. Professional services revenue increased 37 percent to \$33 million.

Total revenue for the year was \$1.73 billion, up 10 percent.

From a geographic perspective, total revenue growth was reported in all major regions for both the quarter and the year with particular strength in EMEA.

For fiscal 2008, license revenue rose 14 percent to \$648 million. We saw solid license revenue performance in the U.S., EMEA and Latin America.

For the year our ratable rate was 50 percent, which was in line with the prior year.

In fiscal 2008, maintenance revenue increased 5 percent to \$968 million. Professional services revenue in fiscal 2008 increased by 27 percent to \$116 million.

Operating Expenses

Moving next to operating expenses:

We had another good quarter of controlling our expenses. Non-GAAP operating expenses were \$330 million, flat with the year-ago period. Our

operating expenses included increased costs from acquisitions and the negative impact of currency movements.

We remain pleased with our ability to maintain our financial discipline. During fiscal 2008, we focused on improving key business processes throughout the company. We continued to expand into lower cost locations, eliminated redundancies in systems and applications, and reengineered core processes.

Looking forward, we continue to believe we can further simplify and standardize our key business processes and we have a number of initiatives currently underway.

We believe these initiatives will continue to help make us a more efficient and more profitable company.

Balance Sheet

Now turning to the balance sheet,

Total deferred license revenue at the end of the fourth quarter was \$555 million, a record level, and up 3 percent sequentially and 10 percent year-over-year.

During the quarter, we deferred \$97 million of license revenue, or 48 percent of license bookings, and recognized \$83 million of deferred license revenue from the balance sheet.

Total deferred revenue increased by \$85 million sequentially to \$1.78 billion.

Our capitalized software development costs were \$113 million, flat with the third quarter of 2008, as we capitalized \$14 million and amortized \$15 million.

Cash and marketable securities at March 31st totaled \$1.48 billion, an increase of \$110 million sequentially.

For the quarter, cash flow from operations was \$210 million. For fiscal 2008, cash flow from operations was \$594 million, up 41% from the prior year and above the high end of our guidance range.

During the fourth quarter, we repurchased 3.3 million shares for an aggregate value of \$110 million. For fiscal 2008, we repurchased 18 million shares at a cost of \$580 million. As of March 31st, we have approximately \$675 million remaining under our existing share repurchase program.

Finally, with the completion of our year end income tax accounting procedures, we identified and corrected immaterial errors in our original calculation of the cumulative effect of adopting FIN 48 and in the calculation of the provision for income taxes for the first three quarters of fiscal 2008. We have included a table in our earnings release which summarizes the income statement impact of these corrections to the first three quarters of the year.

Let me summarize by saying that our performance in the fourth quarter and throughout fiscal 2008 underscores the significant progress we've made in achieving our goals of driving growth, profitability and cash flow. We look forward to continuing this progress in fiscal 2009.

With that, I'll turn the call back over to Bob for his concluding remarks and fiscal 2009 expectations.

Bob Beauchamp:

Thank you, Steve.

As I mentioned, I'm especially pleased with the company's performance in fiscal 2008. We have an even stronger position today as the leader and innovator in Business Service Management.

Looking ahead into fiscal 2009, we see solid opportunities to further the company's position and improve its performance in three key focus areas:

- First, to accelerate the top-line growth of our ESM unit by maintaining a more focused approach in Service Support, Assurance, and Automation;
- Second, to enable our MSM unit to capitalize on the continued stabilization of the Mainframe market and optimize its profitability and cash flow;
- Third, to maintain the discipline in how we run our business in order to yield greater business process efficiencies to support long-term growth.

Let me now move to our expectations for fiscal 2009.

For fiscal 2009, we expect non-GAAP earnings per share in the range of \$2.10 to \$2.20 per share with a seasonal pattern similar to prior years. This

range also assumes an effective tax rate of 30 percent and excludes an estimated 89 cents of special items including expenses related to the amortization of acquired technology and intangibles, in-process research and development associated with our acquisition of BladeLogic, stock-based compensation and restructuring activity.

The assumptions underlying this full year fiscal 2009 estimate include:

- Total bookings and total revenue growth in the low double digits
- A license bookings ratable rate slightly higher than last year
- A continued improvement in non-GAAP operating margin
- 10 cents dilution due to the BladeLogic acquisition, with 6 cents of dilution due to the write down of deferred revenue and retention and integration costs
- Other income that reflects the current interest rate environment

We expect our cash flow from operations to improve to between \$620 million and \$670 million, seasonally skewed to the second half of the fiscal year.

So as you can see, we are expecting a year of accelerated performance across all key financial metrics.

With that we will now turn the call over to questions.

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