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Broadcom Inc. (AVGO) CEO Hock Tan on Q3 2019 Results - Earnings Call Transcript

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FQ3: 09-12-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $5.16 beats by $0.04 | Revenue of $5.51B (8.86% Y/Y) beats by $1.71M

Earning Call Audio

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Broadcom Inc. (NASDAQ:AVGO) Q3 2019 Earnings Conference Call September 12, 2019 5:00 PM ET

Company Participants

Beatrice Russotto - Director, IR

Hock Tan - CEO and President

Thomas Krause - CFO

Conference Call Participants

Harlan Sur - JPMorgan

Vivek Arya - Bank of America Merrill Lynch

John Pitzer - Credit Suisse

Chris Danely - Citigroup

Stacy Rasgon - Bernstein Research

Ross Seymore - Deutsche Bank

Blayne Curtis - Barclays

Toshiya Hari - Goldman Sachs

Craig Hettenbach - Morgan Stanley

Operator

Welcome to Broadcom Incorporated Third Quarter Fiscal Year 2019 Financial Results Conference Call.

At this time, for opening remarks and introductions, I would like to turn the call over to Beatrice Russotto, Director of Investor Relations of Broadcom Incorporated. Please go ahead, ma'am.

Beatrice Russotto

Thank you, operator, and good afternoon everyone. Joining me today are Hock Tan, President and CEO; and Tom Krause, Chief Financial Officer of Broadcom.

After the market closed today, Broadcom distributed a press release and financial tables describing our financial performance for the third quarter of fiscal year 2019. If you did not receive a copy, you may obtain the information from the Investors section of Broadcom's website at broadcom.com. This conference call is being webcast live and a recording will be available via telephone playback for one week. It will also be archived in the Investors section of our website at broadcom.com.

During the prepared comments section of this call, Hock and Tom will be providing details of our third quarter fiscal year 2019 results, guidance for fiscal year 2019, and commentary regarding the business environment. We will take questions after the end of our prepared comments. Please refer to our press release today and our recent filings with the SEC for information on the specific risk factors that could cause our actual results to differ materially from the forward-looking statements made on this call.

In addition to US GAAP reporting, Broadcom reports certain financial measures on a non-GAAP basis. A reconciliation between GAAP and non-GAAP measures is included in the tables attached to today's press release. Comments made during today's call will primarily refer to our non-GAAP financial results.

I'll now turn the call over to Hock.

Hock Tan

Thank you, Bea. Good afternoon everyone and thank you for joining us today. Looking at the third quarter, consolidated net revenue was $5.5 billion, a 9% increase from a year ago. Semiconductor solution revenue was $4.4 billion, down 5% year-on-year and up 6% quarter-over-quarter. Networking continued to perform well, driven by strong demand for our merchant switching and routing platforms, and as we also expected, shipments of custom silicon solutions in AI, SmartNIC, and video transcoding to cloud datacenters were strong.

Wireless is of course seeing the beginning of a typical seasonal uptick and initial positive effects of increased content. These tailwinds were partially offset by weaker demand in storage and broadband. Revenue for infrastructure software was $1.1 billion. The CA business is running above our expectations, benefiting from sustained enterprise demand for our mainframe and distributed software. However, SAN switching demand has paused as our partner OEM supply chain compressed in these uncertain conditions.

Now, let me address the current environment and outlook. Enterprise and mainframe software customer demand continues to remain stable, particularly in North America and Western Europe. SAN switching demand will likely continue to be down another quarter, while inventory in the OEM channels are being worked down.

As it relates to semiconductors, although the US-China trade conflict continues, we have not seen further deterioration in our business, both specific to China as well as globally. Accordingly, we continue to expect to achieve over $22.5 billion of revenue in fiscal 2019, including $17.5 billion from semiconductor solutions and $5 billion from infrastructure software.

Looking to next year. Infrastructure software is stable as renewals among our core customer base continue to be very solid. However, visibility continues to be very limited on the semiconductor side. So, we are managing the business with an expectation that we will continue to operate in a very low growth uncertain macro environment for the foreseeable future.

Fortunately, the fundamentals of our semiconductor business remains strong. As you know, our business is all about connectivity from CPUs to memory in data centers, core to edge in networks, central office to client devices in distributed systems, and here we continue to benefit from the underlying trend in the IT world, and insatiable need for increasing bandwidth to connect things.

In data centers, Tomahawk switching have gone from 3.2 terabits per second just three years ago to 12.8 terabit per second today. In cloud computing, as the limits to Moore's Law constrained CPU and GPU performance, the pipes linking computing cycles to the network and storage expense. PCI Express Gen 4 today at 16G replaces Gen 3 with the likes of next generation Rome CPU. Legacy network interface controllers, NICs as they say are becoming really intelligent, and what we now call SmartNICs and takes on the task of accelerating workloads offload from non-optimized CPU within cloud computing.

Even in SAN, that’s storage area network, fibre channel progresses its bandwidth at 32 gigabit per second in Generation 6 today to Generation 7 at 64 gigabit per second next year to reap the full benefit of all flash arrays in enterprise storage. And to truly connect computer storage replacing direct attach copper, fiber optics running in 100 gig -- 100 G channels are moving to 400 G as our hypercloud customers scale out data centers with Tomahawk 3 today.

Turning to telco networks. Call routing has gone from 1.6 terabit per second a few years ago to 9.6 terabits as represented by our Jericho 2 router today. In broadband, cable modem with DOCSIS 3.0 at 1 gigabit today will move to DOCSIS 4.0 at 10 gigabit over the next few years as cable operators need to compete against 5G networks.

So it is with DSL, digital subscriber line, we're at a mere 500 megabit per second of data flow today, you will upshift to over 1 gigabit per second in G.Fast, which may seem inadequate, so we need GPON at 2.5 gigabit, and even with that we are poised today to launch into mass markets with 10G xPON. Of course, wireless connectivity too has seen the most headline.

And in enterprise access gateways, the protocol has moved from 802.11ac to the new OFDMA enable 802.11ax, otherwise called Wi-Fi 6, and we are at the cusp of cellular communication migrating from 4G to next generation 5G in radio access networks and smartphones. We are enabling these fundamental trends in the marketplace. This gives us confidence that we will continue to sustain and grow our semiconductor business over the long term.

Moving on, let's talk about software, first the CA. As we mentioned, our model for CA is to focus on the 500 largest enterprises in the world, the biggest users of our infrastructure software. Based on experience through fiscal third quarter 2019, we expect our core customer business, that's up for renewal in fiscal year 2019 to grow over 20%. Meanwhile, the attrition rate of business from the long tail of customers behind this core group is anticipated to be over 10% for fiscal 2019.

We have another two plus years to turn over the CA customer contract, but But based on the trends of renewal growth from these core customer base in excess of the attrition of non-core business over the last nine months, we're confident that we can meet if not exceed the long-term revenue and profitability targets that we laid out for CA to you last year when we acquired that business. Our integration activity is largely complete with operating expenses to support CA approaching target levels.

Finally, let me take a few more minutes to talk about our planned acquisition of the Symantec Enterprise business announced in August. Acquiring Symantec furthers our efforts to build one of world's leading infrastructure technology platforms. It allow -- it is the logical next step in Broadcom's infrastructure software strategy, and adds $160 billion cybersecurity market to our -- to the Broadcom's addressable TAM.

We will gain a portfolio of mission-critical security solutions that are deeply embedded among our core customers. There will be meaningful cross-selling opportunities with Brocade and CA solutions, and we believe this acquisition will enable Broadcom to gain a larger share of the wallet of this core customers and we expect this transaction to add more than $2 billion of sustainable run rate revenue with this leading franchises in cyber security and we also expect to achieve in excess of $1 billion in run rate cost synergies within 12 months post close.

And importantly, this transaction gives us the opportunity to achieve -- our ongoing financial objective of double-digit cash on cash returns. The integration planning process is well underway, and as you likely saw, we cleared HSR last week. We remain on track to close the transaction in the first quarter of fiscal 2020 subject to antitrust approvals in the European Union and Japan, as well as of course customary closing conditions.

To sum, a broad and increasingly diversified portfolio of leadership, technology franchises has allowed us today to sustain revenue and increase cash flows even in this challenging market environment.

Now let me turn this call over to Tom.

Thomas Krause

Thank you, Hock. Consolidated net revenue for the third quarter was $5.5 billion, a 9% increase from a year ago. The Semiconductor Solutions segment revenue was $4.4 billion and represented 79% of our total revenue this quarter. This was down 5% year-on-year on a comparable basis. Our Infrastructure Software segment revenue was $1.1 billion and represented 21% of revenue. Free cash flow was 42% of revenue or $2.31 billion and grew 8.5% year-over-year.

Let me now provide additional detail on our financial performance. Operating expenses were $1.01 billion, driven by further reductions from CA-related activities. Operating income from continuing operations was $2.91 billion and represented 52.8% of net revenue. Adjusted EBITDA was $3.06 billion and represented 55.6% of net revenue. This figure excludes $141 million of depreciation.

In terms of working capital, our payables increase of $237 million was somewhat offset by receivables increase of $55 million, and an inventory increase of $57 million from the prior quarter. I would also note that we accrued $110 million of restructuring and integration expenses, and made $164 million of cash restructuring and integration payments in the quarter. Finally, we spent $112 million on capital expenditures.

In the third quarter, we returned $2 billion to stockholders, consisting of $1.1 billion in the form of cash dividends and $977 million for the repurchase and elimination of 3.5 million AVGO shares. We ended the quarter with $5.5 billion of cash, $37.6 billion of total debt, 398 million outstanding shares and had 442 million fully diluted shares for the quarter.

Turning to our fiscal year 2019 guidance. As Hock discussed, we are maintaining our full-year revenue guidance of $22.5 billion, including approximately $17.5 billion from Semiconductor Solutions and approximately $5 billion from Infrastructure Software. IP licensing is not expected to generate a material amount of revenue.

On a non-GAAP basis, operating margins are expected to be approximately 52.5%. Net interest expense and other is expected to be approximately $1.3 billion. The tax rate is forecasted to be approximately 11%. Depreciation is expected to be approximately $600 million. CapEx is expected to be approximately $500 million. As a result, free cash flow is expected to be approximately $9 billion, which does take into account projected restructuring and integration charges of approximately $1.1 billion.

Note, as of the end of the third quarter, $6.9 billion of free cash flow has been generated and includes $969 million of restructuring and integration charges. Stock-based compensation expense is expected to be approximately $2.2 billion, and finally, we expect average diluted share count to be 440 million for Q4 and this excludes any impact from share buybacks and eliminations.

Now on the capital allocation. As many of you know, Broadcom has a business model that generates a very healthy amount of free cash flow across an increasingly diverse and stable set of mainly infrastructure technology franchises. Over the last few years, we have worked to create a more transparent and balanced capital allocation policy.

First and foremost, we have committed to return half of our free cash flow to shareholders each year in the form of cash dividends. In essence, this allows the AVGO stockholder decide how best to reinvest 50% of the free cash flow that we generate.

In return, we have, in effect as the Broadcom struggle to put trust and management to optimally reinvest the remainder of the free cash flow after the dividend is distributed. Fundamentally, we think that we have a unique M&A strategy that allows us to consistently reinvest these excess cash flows that will drive returns well above our free cash flow yields.

Over the past few years, we have developed a road map primarily around Infrastructure Software starting with Brocade, and then with CA and now Symantec that will allow us to continue to execute on the strategy for many years to come. So going forward, our plan is to use this excess cash for acquisitions and/or to pay down debt that we borrowed to make these acquisitions.

Now over the last years, we have bought back a lot of stock. We had an opportunity to buy stock at depressed prices following the CA announcement. We also want to limit the dilution from the one-time multi-year grant we did earlier this year. In all, we have invested $13.1 billion to repurchase or eliminate a total of 54.5 million shares at an average price of approximately $240 per share over the last 16 months through the end of our fiscal Q3 '19.

So in summary, we think this decision made a lot of sense. That being said, maintaining our core capital allocation strategy of dividends and M&A while pursuing meaningful buybacks in parallel has caused us to increase our leverage and leverage multiples pretty substantially.

Especially in light of the weak macro environment we are seeing today, we're conscious of the risks that a more levered balance sheet creates and are very focused on managing those risks. As a result, we have started to transition our focus to deleveraging the balance sheet following the recent Symantec acquisition announcement.

That concludes my prepared remarks. During the Q&A portion of today's call, please limit yourselves to one question each, so we're going to accommodate as many analysts as possible. Operator, please open up the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Harlan Sur of JPMorgan. Your line is open.

Harlan Sur

Good afternoon and thanks for taking my question. Good to see the business bottoming here in the second half of the year. Hock, you know we continue to hear that Tomahawk 3, Jericho 2 are seeing strong demand for the 200 gig and 400 gig cloud networking adoption, also your revenue and design win pipeline on compute networking and security off-load acceleration ASICs is pretty strong with guys like Google, Facebook, Microsoft, etcetera.

Last earnings call, you had anticipated full year double-digits growth in your datacenter networking, compute off-load businesses. Question is, are you still tracking to that and despite the muted growth outlook for the overall business looking into next year, given your design win pipeline, do you expect continued double-digits growth in the datacenter networking and compute off-load looking into next year as well?

Hock Tan

I guess, the bottom line answer is, our outlook, which we shared with you much early on has not changed materially at all. Yes, we do see continuing improve -- ramp of ship deliveries into hypercloud gains [ph] on those various networking as well as computing off-load silicon, and that hasn't changed and that has in fact given quite a lot of buffer to otherwise been a fairly uncertain and difficult markets at this point.

Harlan Sur

Thank you.

Operator

Thank you. Our next question comes from Vivek Arya of Bank of America. Your line is open.

Vivek Arya

Thanks for taking my question. Hock, you started mentioning something about next year and I just wanted to flesh that out. I know you're not giving next year guidance per se, but on the positive side, you're saying business is bottoming, you outlined the number of product cycles or so, but then you sound a little bit cautious on just the environment.

So, I was curious how you were thinking conceptually about next year, pluses and minuses. And then as part of that, if you could also give us some indication of how Huawei figures into that both kind of in the near-term Q4 and next year? Thank you.

Hock Tan

Well, you actually answered my question for me in many ways, which is you're -- you implying -- which is correct that the US-China trade dispute is turning into an extended affair with lots of twists and turns and uncertainty. And we are assuming things on conditions, environment is not going to change from what we're seeing now. And if we make that assumption next year, you probably see a very uncertain 2020.

But as we sit here right now and we probably have another three -- at least another three months before, we probably give you a much more clear 2020 guidance, but as we sit here right now over the rest of this calendar year, if not fiscal year, what we're seeing is, you're right, which appears -- it appears we have hit bottom at least in the semiconductor -- as it relates to the semiconductor solutions side, we have hit bottom and we are kind of looking ahead and saying that we're paying right here more or less with little seasonality that pops up every now and then as we're seeing to some extent probably in the next few months as we see ramp up of our North American -- large North American OEM customer in handsets. But other than that, broadly, we're kind of staying at the bottom.

Operator

Thank you. Our next question comes from John Pitzer of Credit Suisse. Your line is open.

John Pitzer

Yeah, good afternoon guys. Well, thanks for letting me ask question. Hock, I realize that you're trying to stay away from giving too specific guidance by business line, but I'm just kind of curious relative to your comment on the wireless side of the Semi business, how should we think about this build cycle for you this year prior -- relative to past years when -- there is a view that you're gaining content on the RF side, you've got Wi-Fi 6.

Your largest customer is also not staggering their phone launch this year. They've got some tariff issues that they might want to pull in some builds, so I just -- as you look at the results for the July quarter, were they up sequentially kind of in that mid-teens level, how do we think about October and how long is this build and what's the seasonal look into January? So if you could give us any sort of color that would be helpful.

Hock Tan

Well, it's always in this kind of -- even in this kind of program, we have limited visibility as provided by our customers how far we can go. And to be very specific about what we are asking in wireless, as -- as we've always done in previous years, we see beginning of uptick seasonality in Q3, which is the July quarter, and we'll see more of it in our last quarter of the fiscal year, which is October quarter, and we fully expect to see that.

And frankly that's as far as we see in this typical kind of outlook, because it obviously depends at the end of the day on reset of our OEM customers. But we do see that this year, we do not see any major departure from that; and you know year-on-year, things are quite predictable in this respect.

But having said that, as you know, we are a Company much more than just wireless today. In our -- even in our Semiconductor Solutions, we have broad areas where we participate in and there are multiple puts and takes as I kind of indicated in terms of what happened in Q3 and while we see continuing strength in networking, computing offload in the data centers, we do see some weaknesses in storage and broadband, and it will probably -- things might probably look better next quarter for wireless, but maybe there are some other areas of mitigate and that will go the opposite way.

But broadly, given our large portfolio and broad diversity and the fact that we are very fundamentally strong in each of those areas we are in, which we are saying -- what we are seeing and what we're saying here is that in the semiconductor macro market, which is where they are pretty well represented on average, we are not as strong as it was same time last year.

And if you look at our data so far this year-to-date, we're down probably on average of about 8% year-on-year or thereabouts, which is in my view, what we are seeing -- what the market -- what we think the market is on a broad basis excluding memory of course. And the fact that we were year-on-year down more in Q1, Q2 this fiscal year and probably less down in the back half of fiscal '19 should not be taken as a fact that that's the bottom and there is possibly a recovery.

That's why we made the statement. We know we are pretty confident we are at the bottom. The question is, there is not much clarity or visibility yet or certainty that any sharp recovery is around the corner.

Operator

Thank you. Our next question comes from Chris Danely of Citigroup. Your line is open.

Chris Danely

Hey, thanks guys. Hey Hock, can you talk about the expected timing of the 5G ramp, especially for your ASIC and ASSP business. When you think that starts? Is this has been pushed out at all? Is it about as good as you thought it would be three or six months ago or has the forecast changed and how much?

Hock Tan

Well, that's a tough question in terms of that, because to be honest with you, you know we do not participate that much on 5G ramp on radio access in a broad perspective. We thought -- we thought at the handset level, we touched someone at the radio access, but we believe we probably touched most at the backhaul, the networks. And I think each of them ramps -- will ramp 5G at different times.

So our -- in our perception -- in our ability to see what -- how big that ramp is at any particular point in time, it's also dependent on the fact that -- the fact that different operators in different countries were probably want to ramp up at different points in time, different parts of the network, whether it's a front side ramp or the backhaul. And my guess is probably, you won't see much of it until later this year, early part of next year. As far as we are concerned, which is more of the backhaul where it affects our numbers.

Operator

Thank you. And your next question comes from Stacy Rasgon of Bernstein Research. Your line is open.

Stacy Rasgon

Hi guys. Thanks for taking my question. I wanted to know, you've had a growth target for semi's of mid-single digits, and obviously we're in an uncertain environment. But you also talked a lot about, I guess, company specific drivers and product cycles that fundamentally can still drive.

So I guess, are those fundamental drivers are enough to keep the semi business growing at least somewhere in the ballpark of that sort of mid-single digit long-term guidance even in an environment that's uncertainty. I guess, maybe even put a different way, could you maybe talk about specifically some of the product cycles and trajectories that are may be unique to Broadcom that you see kind of ramping next year and maybe compare with what we had this year across your different businesses?

Hock Tan

Well, yeah, when I went on this quantification of the various trends driving the fundamentals of our product lines and our semiconductor business, I really wasn't thinking necessarily and if I give the wrong impression, I do apologize, one year. This is our ongoing trend. And I was using examples, because these are examples ongoing that we see today, recent past and going forward in the future.

But what I do see is that, yeah, then all this areas we participate in from -- as networking in data centers, routing in core and metro networks, in cable and broadband where we all are -- one thing is clear, which is the nice thing we see in technology, especially the semiconductor technology, there is a constant evolution of the products we do, that's constant demand for improved performance or if I put it increased bandwidth, in essence, we do connectivity.

And depending on a -- in a particular applications, some may spend a year, some may spend three years to make a transition, but they do happen and they continue to happen and that one keeps demand sustain for our technology, for our products, and that's what underpins as reported a long-term growth forecast in semiconductors for us of mid-single digits. And I don't mean a year, I don't mean necessary even two or three years, I mean over the next five years, 10 years, because think about it right.

In 2018 fiscal, our semiconductor business organically, take out all acquisitions, grew 12% year-on-year from '17. And in '17, we grew another -- over 16%, about 10% organically. So I frankly do not expect that high rate to double-digit rate in this business where we have pretty well represented across a broad area to be able to continue at that rate of growth. And so we see in '19, a decline from a -- from a strong '18 as I said, probably mid to high-single digits. Not unexpected and -- but taken over a period of multiple years, we believe we have -- we will achieve that mid single-digit compounded annual growth rate but I won't do that every year. Thank you.

Operator

Thanks. Your next question comes from Ross Seymore of Deutsche Bank. Your line is open.

Ross Seymore

Thanks. Tom, I had one for you on the capital return side of things. In the past, that 50% dividend policy you have, it's very clear, but the free cash flow that generates that at times has been a little more subjective due to one-time charges finishing the classic Broadcom campus, etc. So how does restructuring charges, how do they fit into the math of free cash flow. And then the investment grade target where you want to keep it there, what sort of leverage target should we think about with you guys more aggressively paying down debt as opposed to repurchasing shares in the near future?

Thomas Krause

Yeah, I think on the cash flow side, Ross, what we've tried to do is create somewhat of a formula, because we do typically have acquisitions and we do have investments we make to get to the synergy targets. And in fact what we're trying to do is deliver the benefits to the stockholders the year with which we are able to achieve those synergies. So what we've done, as we said, look, what would it be free cash flow from operations, which obviously includes was restructuring charges and what's add back those for the purposes of calculating the dividend.

So when we get to the end of the year, we will take the cash flow from operations, we will add back the restructuring, integration charges and in fact will divide by 2 to get to the number that we use to calculate the dividend. This year we don't have any specific one-time large campus initiatives of things like that that we would also want to back out. So that should be a fairly good proxy for how we think about the dividend and the recommendation of the Board at the end of this year.

In terms of investment grade, I think we've talked about this before, but maintaining investment grade similar to the dividend policy is a core principle here, and I think the reason for that, Mark and I discussed it many times internally is, it provides maximum flexibility for us to continue to pursue our strategy. It's always been very important. And so over time, we had this one-time event.

We bought back a bunch of stock as I talked about in the prepared remarks, that's pushed leverage up more so than we normally would. We think based on the economics and the results so far that was the right decision, but we're really looking forward to going back to the playbook we pursued in the past which is following the distribution of the dividend.

Now we still have a lot of cash flow and that cash flow we think based on our strategy is best use for M&A because that's where the returns are most optimal. But as part of that, we often borrow money to finance those acquisitions, and then we go and pay that debt down. So I think we're going back to a more traditional playbook and as part of that given the size and the scale and the increasing diversity of the business and the share profitability and the cash flows, we're very much an investment grade company and we're going to be very focused on maintaining that investment grade status going forward.

Operator

Thank you. Our next question comes from Blayne Curtis of Barclays. Your line is open.

Blayne Curtis

Hey guys, thanks for your question. Tom for you, just on the annual guidance for OP margin would suggest a tick down into October, I just want to make sure how literally to take that, and if so, can you talk about any drivers as to why profitability to be coming down in October? Thanks.

Thomas Krause

Yeah, it's a good point, and maybe we're a bit conservative to be honest, when I think the reality as you see the mix shift in the second half of the year. We've got a couple things going on. One with wireless ramping seasonally as Hock discussed, those margins are not as high as the rest of the portfolio. And then on top of that, we are giving back some on the SAN switching side in the back half which is fairly high margin product. So we thought it made sense given the mix to stick to that number and that's why we're staying there.

Blayne Curtis

Got you. Thanks.

Operator

Thank you. Our next question comes from Toshiya Hari of Goldman Sachs. Your line is open.

Toshiya Hari

Yeah, hi guys. Thanks very much for taking the question. Hock, I was hoping you could talk a little bit more about what you're seeing in the hyperscale cloud environment. A couple of your peers are -- quite a few of your peers have talked about signs of recovery into the back half and potentially into 2020 following a pretty extended period of weakness. I appreciate you guys have drivers that are very specific to the Company. But in terms of customer sentiment on spending and capacity expansion, what are your thoughts there? Thank you.

Hock Tan

Okay. Well, it's a very interesting question. And I guess I put it two ways. One is touching on cloud spending. We pretty much see some of what a lot of people out there are saying in common lately, which is an improvement in cloud spending in multiple areas, especially in scaling out new generation datacenters as they expand their business. We obviously benefit from that in our switching, routing in some of our specific custom off-load programs in AI or just SmartNIC. So -- and we see that, but as we all know these days, cloud spending is starting to be a bit like telco spending very lumpy.

What we see on the other half of our business in infrastructure is we've enterprises, end users, and here from the viewpoint of an opportunity to see end users directly and we see end use -- enterprises or end users who are the end users, especially the largest bunch of our core customers, their spending continues.

Their IT budget is pretty strong and they're spending continues because they need that digital transformation as their business continues fairly decently and that hasn't impacted, which is why our infrastructure software business, renewals continue to grow very nicely. And that's not an issue. It's when we sell components to OEMs, who then make it into systems to sell to these same end users, then we see a difference.

And the difference is simply that, I think given as far as we could gather -- given uncertainty in this environment that everybody is constraining -- all our partners are constraining their supply chain and compressing the supply chain, so to speak, and then action of compressing is really a reduction in orders, a reduction in what appears to be demand. So it's really interesting as we see it.

That on our software side, things are direct sales to large enterprises continue fairly unabated. But when it comes to selling components through partners to the same end users, we're seeing a different perspective, slowdown, a constrain, and it's reflected obviously in the numbers we are showing here. And it also is reflected in the outlook that we are giving to you guys.

Operator

Thank you. Our next question comes from Craig Hettenbach of Morgan Stanley. Your line is open.

Craig Hettenbach

Yes, thank you. Hock, switching gears to CA in the software side. Can you talk about just some of the efforts around portfolio license agreements, specifically what kind of sales efforts you have in place there and what this could mean for the business over the next couple of years as you try to gear it that way?

Hock Tan

Yes. Well, it is in the portfolio licensing arrangements as soon as a sales model or business model we apply to our infrastructure software business, which is CA at this point. In my mind, and to be fair, it's less than a year since we launch it, but I -- we since we took over CA only the last November has been I would call it very successful. It has been very encouraging and a big part of why we think it is encouraging the way it works is, because we just focus on the largest 500, 600 customers of CA.

These are guidance where we have large decent signs for large footprints to begin with, and as we go towards renewals, with our ability to offer a portfolio-wide licensing arrangement, a limited capacity on the full range of products -- broad products that we have that extend beyond -- from mainframe to distributed software is extremely attractive and cost effective to those large enterprises who buys a lot of those Infrastructure Software. So we have done multiple deals as rental multiple renewals and we continue to be very engaged with those companies.

So I guess my conclusion is by focusing on these largest customers we've large -- where we have large footprint that exists and where they ability to consume more of those software we have is mix a lot of sense. And as I put in some of my comments earlier on and this -- and this ability to focus on these largest guys and put the sales motion technically and commercially very effectively on this large customers and possibly not focus on the long tail of non-core customers is a key part of the whole model and what makes the whole model works simply because conceptually we are reviewing those contracts with larger footprints on portfolio licensing agreements as I mentioned at a rate of over 20% annually.

While we are probably because of lack of focus, reducing or attriting smaller non-core customers at 10% and those core customers represent 80% of our overall revenue where the long tail represent only 20%, ends up in a situation after one year -- almost one-year where we show a net gain of over 10%. Keep that going, three years later, we reached the average term of every contract we put in place. We would see a clear step up in our revenues from this business of -- we'd like to believe double-digit growth.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.