Spirent 2021 Half Year Results Live Q&A Session with Analysts

Eric Updyke:
Good morning, everyone. I'm Eric Updyke, CEO of Spirent, and I am joined by Paula Bell, our CFO. I hope wherever you are, that you and your loved ones are all well and keeping safe in these strange times. And hopefully, by now you've had the time to stand to listen to our half-year 2021 results presentation. If you haven't, I would encourage you to do so, and I would alert you to the fact that it is available on our website, at corporate.spirent.com.

Paula and I will take any questions you have shortly. But just before we do I want to provide a few opening remarks. I'm really pleased to report that Spirent had another strong half, with orders up an impressive 14 per cent, and revenue up 9 per cent. This is on top of our continued strength through 2020 during COVID-19. These strong numbers provide further evidence that our strategy is working, and our strong order book means we have more predictability and visibility.

We have enduring market drivers and we're proud of the technical leadership positions we hold. Among our drivers, 5G and Lifecycle Service Assurance are continuing to see strong momentum. Our solutions and services portfolio is expanding our leadership positions, enabling us to solve bigger problems for our customers, and decreasing our cyclicality. We've expanded our P-Accounts program to continue executing on our strategy, and we have a strong platform to deliver on it.

Touching on a few of the half-year 2021 performance highlights were market leaders and 5G Test and Insurance markets, and we continue to win key deals, including over 400 deals in the first half. Our Lifecycle Service Assurance delivered strong revenue growth at 17 per cent, with 5G driven growth across its lab and life portfolio. LSA also announced an exciting collaboration with Amazon web service to deliver automated 5G network testing using Spirent's landslide test automation capabilities.

Our focus on solutions and services continues to land new business and has increased in visibility. All parts of our portfolio delivered good growth while increased multi-year contract award resulted in order book growth. We continued expanding into new customer segments and geographies that will focus on hyperscaler and government customers. In the half, we began our targeted M&A, with the acquisition of octoScope in tier one this year, and continue to invest in organic growth while we evaluate other inorganic opportunities. OctoScope has established Spirent as the firm Wi-Fi leader in a growing market. Our integration plans are on-track, while customer feedback has been positive.

Innovation is key to our market leadership. We continue to invest in R&D across the portfolio, developing new, easy-to-use solutions for the business problems of today and tomorrow. Looking ahead, our strategy to focus on market-leading technologies to address our customer challenges is delivering strong results, evidenced by strong orders, revenue, and profit growth in the period. We continue to increase our visibility, and by expanding our services and software offerings, we're driving sustainable revenue growth while decreasing cyclicality risks in the portfolio. We maintain strong relationships with our customers and supply chain to ensure the impact of any market disruption resulting to COVID-19 pandemic is reduced. And, innovations investment across the portfolio that support the growth agenda remains a key priority. We're also curating an opportunity pipeline in support of our M&A strategy. As the pace of demand for support from our customers continues to grow, we remain well placed to benefit from market opportunities as they arise. And although the outlook for the year remains unchanged, the board is increasingly confident the group will continue to see sustainable, profitable growth in 2021 and beyond.

Now with that, Paula and I will be very happy to take any questions you might have.

Male Speaker:
Ladies and Gentlemen - welcome to the Spirent Communications PLC 2021 Half Year Results Q&A session. Hopefully
by now you have had the chance to listen to the results presentation, which went live at 7:00 a.m. UK time this morning, and have acknowledged the safe harbour statement.

On the call today we have Eric Updyke, Chief Executive Officer and Paula Bell, Chief Financial and Operations Officer, who will be answering your questions. Please be aware the session is being recorded and will be added to the Spirent Corporate website.

To ask a question, press star followed one on your telephone keypad. If you wish to retract that question, it's star followed by two. And when prepared to ask your questions, please ensure you are not muted locally. So, the first question today comes from Francois Bouvignies of UBS. Francois, please go ahead.

Francois Bouvignies – UBS:
Hi. Thank you very much for taking my questions. The first one, maybe is on your command around multi-year contracts. And, you know, given the strong pipeline that you see, can you help us understand the visibility that you have now? I mean, in the second half of the year, but also towards 2022, it seems that the industry, given the tightness across the board, seems to have more visibility short and medium-term I would say. So, can you help us understand that what is your visibility on your side, and I have follow-up after that, if you don't mind.

Eric Updyke:
Yes, sure. Thanks, Francois. And I'll ask Paula, in a moment, to give a statistic or two. But I just want to comment on kind of, you know, what's driven the strength in multi-year deals. So, and one is, we put a big focus on it. And, you know, it is important to us, and I think all our stakeholders, to have more visibility and predictability in the business. And so, it's the kind of thing that we put a big focus on, and it's working. You know, we're executing upon it. To me, having success in that regard, it is evidence that we're adding value to our customer's business, and that, you know, they respect and trust us and want to continue to work with us. You know, for the foreseeable future. I think it speaks well to our reputation, and the way customers perceive us. But, Paula, do you have any further comments you want to offer around the -- kind of the nature of the additional visibility it's given us?

Paula Bell:
Yes, for sure. Let me give you some numbers. You know, we're bringing in about six per cent of our order intake, as multi-years and that compares to about four per cent, half from the previous year. For when I look at the order book analysis, and I look at the detail of when it's going to turn into revenue, we have $19 million in our order book, which is 43 per cent, which is the delivery beyond '21. And that compares to about 72 million the previous year. So, this is really great progress, and as Eric said, the focus on the types of deals. Bringing our customers along with us for a longer, outward duration is creating that increased visibility. But hopefully those numbers they give you a little bit more statistics around it, Francois.

Francois Bouvignies – UBS:
Yes, it does. That's good, actually, thank you. And maybe on the exposure, or maybe your efforts towards hyperscalers, data centers, can you help us understand where you are now, the progress you are making? Any data around that would be great, thank you.

Eric Updyke:
Yes. So, it is something that -- well, less than 12 months ago we really beefed up the sales focus on that market segment. And I think it's already paying dividends. You know, it does typically take some time to develop relationships and to see the progress, you know, in winning business after investing in making incremental investments in certain customer segments. But we're really delighted that we've made a lot of great inroads across all the big names that you would expect amongst the hyperscaler base. We referenced a nice win at Amazon, but it's just one, actually, of several. And I think in a lot of respects it's kind of tip of the iceberg, because as I said. If we add value the way we expect to, there are obviously giants, you know, with big budgets. And, you know, I think we're just getting started there. So, you know, traditionally, we really, you know, our bread and butter was, of course, traditional telecommunication service providers and network equipment makers. You know, the relationships of those customers will always be important. But increasingly, hyperscalers are going to play a bigger role for us. And in certain dimensions, they will be the early adopters for some new technologies. So, it's really valuable that we add the kind of strength and focus that we do, in the momentum now, with that customer segment.

Francois Bouvignies - UBS:
Thank you. And maybe one last one for me if I may. If you look at your mid-term targets of 4-5 per cent in the medium term, do you assume, or do you make any, you know, I wish I would say market share towards hyperscalers in this? Or is it, like, an upside of [unintelligible] to get traction for you to get mid-term revenue target?

Eric Updyke:
Yes, I mean, our outlook -- our sort of expectation -- is sort of an all-in assumption across the customer base. I would say that, you know, as we sit here, you know, in early August, into this half-year achievement, we were -- because we came into the year, you know, it was a very unusual sort of comp in 2020, of course. It continues to be, you know, a challenging environment in a lot of respects. You know, COVID is still an impact, and in different parts of the world, and in different ways, and it's had impacts on supply chains and so forth, but we've really seen nice momentum in the business, you know, as we've gone through the year. So, we're -- as always, there's a lot to do in the second half, and we still, you know, despite all the great progress we've made in more software, more multi-year deals, more services, more business in the live network and not just the lab, all of which are very, very much aligned with our strategy and what we laid out at Capital Markets Day last October, there's still a lot to do

in the second half of the year; right? And so, we feel quite optimistic about the momentum that we have, you know, as we sit here today.

<u>Francois Bouvignies – UBS:</u>
All right. Thank you very much.

<u>Eric Updyke:</u>
Yeah, thanks, Francois.

Male Speaker:
As a reminder, it is star-one to ask a question. And the next question comes from John Karidis of Numis. John, please go ahead.

<u>John Karidis - Numis:</u>
Thank you. Thanks. Good morning, Eric. Hello, everyone. I just wanted to ask -- first of all, I'll ask one question of Eric, and then I've got a couple for Paula, please. So, if you can, Eric, just to sort of try and be -- give us some numbers or stats, so you've been working to grow Spirent's reach into hyperscalers and government, and also in new geographies, as you say in the statement, such as EMEA, but quite frankly, at this stage, a bit like Francois, I don't actually know how much revenue you earn from hyperscalers and the government, excluding your Positioning business. And I guess, worse, I don't even know the order of magnitudes of revenue that you hope to earn over the next few years. If it's possible to help me, that would be really good, and similarly, please say which countries you're looking to expand into in the next few years. And again, at least give us some sort of order of magnitude of revenue that you hope to earn in these, please.

<u>Eric Updyke:</u>
Yeah, hey John. Good to hear from you. And, well, I may not give you as much satisfaction as you desire in terms of detail here, but I will tell is it relates to hyperscalers and governments. I really believe we were under index in those spaces, and so we've put focus on it. I feel like we're scratching the surface, really. I mean, the deals that we're getting, you know, are nice-sized deals. They could be, you know -- and for us, deals that are over a million dollars are really nice-sized deals, and we have, you know, a few of those in that space. But it's -- we see great momentum. It's early days. We see a growing pipeline, typically in the government space with our partners as, you know, we work with defence contractors and, you know, people that face the government. We have several large bids pending, you know, that we're chasing new business. So, we've landed some nice deals already; there's a bunch more in the offing. And I think, you know, probably as we exit 2021, this, you know, may be material enough that we'd be in a position to sort of break it out and get some better visibility around just sort of order and magnitude.

You know, in terms of new geographies, the areas where, you know, we're most focused. You know, we've got a strong base, of course, in a lot of, I'll say, organizational muscle in, you know, in the U.S. and in North America more generally, and certainly, within Asia; China has always been, you know, a very strong point for us. So, the areas that we're really looking at for expansion are Europe, including Eastern Europe; select countries there. And sort of rest of Asia, and developing Asia, in particular, where, you know, we don't' have as much of the historical base of business. We relied a little bit more on, you know, channel partners to get to market with some of those customers, but as we achieved some success, we're going to put more of our own dedicated resources in some of those markets. The other thing beyond just new geographies, we are going to continue to expand our key account management programme. We've added two more; we're up to ten, and we have plans to take that further. We're looking at, you know, at least two more over the next, you know, couple of quarters, and maybe more than that. It's been very successful for us. It gives us much better visibility to those key customers, and so, it requires an investment, but we found that where we do it in a targeted way, and we get the right folks on board, we've got a very good ROI out of it.

Paula Bell:
Eric, I've just got a bit more colour for John to point him in the right direction; a couple of things here. John, there’s an appendix called "driving expansion," we're getting fed up to give you more data and trends on revenue by customer type, and you'll see for first time we’ve introduced the hyperscaler slice of the pie chart, so more on that to come in due course. And in note three of the press release on the accounts, you'll find more colour on individual regions and a bit more colour by country, so a bit more information there for you.

But as Eric said, sales investments that we made in the first half, there's been some very much direct target investment into restructure around government and hyperscalers, and indeed, we've been investing small [unintelligible] in various parts of Europe. So, more on that to come, but we're getting fed up to give you more trend analysis on both of those things.

John Karidis - Numis:
Thank you. Thank you, both. If I may just ask the two number-related questions. So, a year ago, you did say that your top 10 accounts generated 44 per cent of total revenue; that was the first half of '20. What was the number for 2021, please? And then, secondly, so that I don't interrupt you again, I think it's been about two and a half years since you actually had a working capital outflow. And also, this morning, Paula, you told us that with service contracts you get paid in advance, and so I guess I'm trying to get my head around what would actually need to happen, operationally, for Spirent to actually incur working capital outflow, whether it's this year or going forward, please?

Paula Bell:
Yeah, some great questions. Take the first one, the top 10 was just under 40 per cent for the half year, but I guide you, it's only the half-year number; we'll wait and see where it lands for the full year. So, that's implying we are diversifying to other customers, which is good, but we'll see where we land for the full year. Working capital's interest in Spirent, it's a lumpy, chunky business, and timing can affect the one-day cut off on the 31st of December. So, a couple of things can happen on the 31st of December. We're certainly very busy leading up to that final day of the year, as you know, with the weighting in our business, and we do bill an awful lot of things in December that increases working capital. We're also very busy bringing lots of inventory to make sure we're well-supplied to hit all the short demands for deliveries that also comes through in December.

So, that's going -- in December. And the new nuance we're seeing, is of course, the more support maintenance that we sell, it comes with a nice little working capital benefit. Now, the timing of all of that on the 31st of December is a difficult one to call. So, you're right, the working capital is reducing, and also with great debt collection, of course, which is the continued focus in my finance team. So, I'm still sticking with working capital overall increase for the full year, but I'm always delighted when I'm proven wrong and we keep reducing working capital. Cash conversion is the first part was 127 per cent. So, it's not something which I will set my [unintelligible] and ever-increasing ratio such as that. So, I'm going to have to wait and see how services plays out against the working capital model, John, to be honest with you, for December, and the 31st of December is a big deal for invoicing a lot of high-speed Ethernet out the door, so I have to wait and see.

John Karidis - Numis:
Thank you, both, very much.

Eric Updyke:
Yeah, thanks, John.

Male Speaker:
The next question comes from Will Kirkness of Jefferies. Will, please go ahead.

Will Kirkness – Jefferies:
Thanks very much. I've got three questions, please. I'll just run through them. Just to follow-up on the percentage of revenue from the top 10, you said just under 40 per cent Paula -- I'm assuming that's all the sort of key account management customers, then, but happy to be corrected if that is wrong, so I just wondered what the revenue base was on the key accounts. I wondered if you could give us any colour on how fast that's growing, and if there's any difference in margins. Secondly, July sort of, maybe, just fizzled. I just wondered if you talk about whether the trends and the strong revenue trends you saw in Q2 have continued. And then, lastly, just whether you're seeing any challenges in recruitment or any extra wage inflation beyond what you would normally see. Thank you.

Eric Updyke:
Maybe I'll speak briefly to the first and the third point, and then I'll ask Paula to add more colour, but you know, the top ten isn't necessarily just the key accounts. I think others that -- you know, because it can change quarter to quarter or half-year to half-year, in terms of who's driving the biggest revenue, but it's largely made up of those key accounts, and others that make their way into the top ten, obviously, become candidates -- become key accounts as we extend the programme. I think, as Paula said, the fact that, you know, we still view this programme as being very successful, but the fact that our top ten is actually reduced as a percentage of our overall revenue by a little bit, it's a really good news thing in terms of how we're diversifying the business, you know, and the reliance on really any one customer, any handful of customers. So, we do see it as a real positive.

Now, on the recruitment front, yeah, I mean, I think the, kind of, war for talents is definitely heating up. I think we've got a great employee value proposition, and we've been able to attract, you know, some really strong talent, and in some areas where there's a real demand for talent, you know; cloud skills as an example, which of course, is in very high demand, and you could imagine who we have to compete against in terms of other marquee names for that sort of talent. But I've really been delighted with the -- we've made a lot of investments in, you know, in adding new leaders to the business, you know, really through the pandemic, even over the last 12 to 15 months, and I think we've really made some great upgrades, you know, to the folks that we've got on board in the company. But it is without a doubt, I think, a competitive labour environment, particularly top talent and other kind that we're trying to attract, and particularly for those critical skills, but in large part, again, because we've got, I think, a great value proposition for employees. We've done a very nice job in having retention success, much better than, you know, benchmarks in the market, in general. Paula, you want to say more about, sort of, revenue trends and so forth?

Paula Bell:
Yeah, just a concern: Will, your questions Q2 into Q3; was that the question?

Will Kirkness - Jefferies:
Yeah, just obviously, we saw good revenue very thin Q2, and I think the comp necessarily gets any more challenging, so I just wondered if you got visibility on July, whether you've seen a continuation of that momentum?

Paula Bell:
Yeah, so it's early days in Q3. I did make reference in the commentary that went along with our presentation this morning that we've actually -- particularly in our Positioning business, landed some particularly large material orders, which we are delighted with that will expand revenue into both this year and next year, so that was a great start to July, for that particular part of the business. And we've all been waiting how the government spends the GNSS products comes back, and we're delighted with that; really delighted. So, yeah, other than that, the trends are really continuing, but you know, as we sit here in August, we're just closing out our July figures right now, actually, but we're on track for delivering our full year. So, not really too much to say at this point, but a little bit more colour on the Positioning business.

Will Kirkness – Jefferies:
Okay. Thanks very much. And, Paula, if I could just follow-up on the key accounts, so in terms of whether they're growing quicker, I guess they've potentially shrunk, but I don't know if that's because you've added more customers or your other customers are growing as quickly or faster. And then, just wondered whether you could help with if there's a difference on the margin profile. Do you see a better margin profile with your key accounts?

Paula Bell:
Yeah, I mean, I'll take that. Generally speaking, the key accounts will deliver superior growth in the group average. Having said that, sometimes their phasing of their spend can move around a bit during the course of the year, aligned with the fact that we have a busier H2, of course. We have changed the remuneration of the key account's sales executives to be based not just on the size of the orders they bring in, but the profitability of the accounts. And by nature of doing that, they've got everybody focused as mini P&L managers on the key accounts, as well, and that makes sure that we've got the focus on the top line and the bottom line. So, yeah, we go and get superior margins, and we get growth, and that's why we continue to invest in sales executives for the key accounts. And, indeed, I'm going to be adding more in the coming months. So, yeah, so that's where we are with that.

Paula Bell:
Will, does that help you with that one?

Will Kirkness – Jefferies:
Yeah, it does. Perfect. Thank you, very much, indeed.

Paula Bell:
Jolly, good. Thank you.

Male Speaker:
The next question today comes from Kai Korschelt of CG. Kai, please go ahead.

Kai Korschelt – Canaccord:
Yeah, hi. Good afternoon, Eric and Paula. Well done on the first half. Congratulations. I had a couple questions. The first one was around 800G demand, which I think you've referenced. I believe Keysight announced a product early this year, so I guess the first question for me is, you know, do you have a sort of commercial product out there yet, and secondly, is, you know, there a possibility that, you know, rather than perhaps seeing a post-post-400G, you know, sort of lull at some stage that there's sort of almost direct transition into 800G. So, I'm just, you know, curious what, you know, what your customers are sort of suggesting in terms of the timeline and roadmap, here. And then, the second question was around just the nature of the multi-year orders, you know, that you've been sort of successfully booking in the first half. You know, if you could maybe give us a bit more colour around the, you know, products or services that you are delivering. I believe you talked about sort of testing as a service before, you know more generic, perhaps, maintenance and service, but I don't know. I'm just wondering if there's, you know, if any sort of, I guess, new product, you know, wrappers, that you have created that support this. Thank you.

Eric Updyke:
Yeah, sure. Thanks, Kai. Yeah, so as it relates to 800G, I think we are very much at the front of the pack in terms of technical readiness and support for 800G, but the kind of engagements that are going on with customers now, I would say, are, you know, early proofs of concept and so forth; they aren't sort of the volume-plays, but we think we're very well positioned in terms of readiness of our technology. And you know, I do think, in general, you know, 800G is, you know, beginning to percolate in this way, and so we, yeah, we're not terribly concerned about there being any kind of big dip or drop-off in transition from 400G to 800G. You know, I think the max port speed kind of transition, we think, is a lot less impactful to that part of the business than maybe it once was at some point in the past. The whole move toward, you know, mobile edge compute, which is driving the need for, you know, testing of even lower port speed because, you know, a lot of shooting power is being moved to the edge of the network, as well as some other moves that we made to really integrate more directly our security solutions, and business with our high-speed Ethernet business has given us, you know, end-to-end solution up and down the stack, sort of across the layers to up to layer seven through the application layer that many customers are finding very valuable. So, I think there's a lot more in terms of the value that we're adding into the new pricing and software business model that we've introduced in that part of the business that are all going to be beneficial in terms of, you know, kind of smoothing things out, there.

You know, around the nature of the multi-year deals, it is, you know, something we are really proud of and we've put a lot of focus on. So, you know, one dimension, you can look at just more traditional maintenance and support agreements, and sort of the extension of those, and I think that is just a positive indication that customers are excited to continue to work with Spirent, and are happy to sign up for, you know, multi-year, ongoing engagements with us. But that is, as I said, sort of the more traditional sort of just maintenance and support.

What is interesting, and where we've done a lot of innovation around the new services portfolio, is in things like test as a service. We sold several new tests as a service engagements. And in fact, some of those that we sold initially, we've been able to extend the duration of those deals, and upscale those deals. You know, we gave, you know, kind of a depiction of a customer journey of one particular customer where we just showed how, you know, in the results presentation this morning, it showed the way in which, you know, initial tests as a service engagement led to some incremental opportunities to help that customer automate their change management process. And then, after we'd done a lot of this work for them in the lab, it translated into some great opportunity for us in their production network, as well, so that lab to live journey, it's a real-life example of how we've made that happen.

Additionally, another, I think, innovative service offering that we brought forward, you know, we've had, you know, our Fit4Launch business where we do, you know, benchmarking of networking and device performance in the field. Well, one of the things that we've put an incremental focus on and it's led to some nice opportunity for us, is doing broader network benchmarking, you know, for some of our customers, and it's led some nice-sized engagements, and then we've executed on it really well. There's an opportunity to, you know, extend, you know, a few of those engagements, and we've been brought into some opportunities. Particularly in the U.S., there's this new requirement, as an example, for E911 accuracy. You know, there was always requirements on latitudinal and longitudinal sort of accuracy of that service, but now, it's being mandated that sort of in the vertical domain, you know, up a high-rise building, that there needs to be certain accuracy, as well. So, we're doing some work to test and verify verticals; the axis accuracy, as well. So, you know, every one of these plays in to sort of the opportunity for, you know, longer term deals and multi-year visibility beyond what we just would have done maybe historically around maintenance and support.

Kai Korschelt – Canaccord:
All right, that's great. Thank you, Eric, very helpful.

Eric Updyke:
Yeah, thanks, Kai.

Male Speaker:
As a reminder, it is star-one to ask a question. It appears we have no further questions. I'll hand it back over to you, Eric.

Eric Updyke:
All right. Thanks, Jake. I just want to thank everyone, again, for joining, and look forward to talking to you all again soon, some in the coming days, I guess. So, thanks very much.

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