Spirent - 6 August 2020

Eric Updyke:
Morning, everyone. I trust and hope that everybody is doing well and had a chance to see our half year results presentation that we posted online, given we couldn't do a face to face this time. And we're happy to answer any questions you may have.

Operator:
Thank you. As a reminder, ladies and gentlemen, it's star followed by one on your telephone keypad to ask a question. Our first question comes from John Karidis of Numis Security. John, your line is now open.

John Karidis:
Thank you. Good morning, Eric. Good afternoon, everyone. Hello. Hello. I just needed to ask if I may, three questions. The first one is Eric, so you'll be hosting a Capital Markets Day in October. And sort of a key lingering concern by some investors is that the business is very cyclical and very much affected by tech cycles. Maybe without stealing your thunder, you can talk around how we should hope that the capital markets, they will address this concern.

Secondly, I just wondered to what extent COVID is still holding back your effort to win new customers both in existing and in new geographies.

And then thirdly, I guess for Paula or both of you, whatever you wish, of course. Apart from general caution, because of the pandemic and its impact, are there any reasons why Spirent's revenue growth in the second half of this year should be less than what you've reported this morning for the first half. Thank you.

Eric Updyke:
Sure. So I'll try -- I'll take the first two and then we'll bring Paula in on the third. So as it relates to Capital Markets Day, we were really looking forward to having that event end of April, of course, and our plans and the plans of many other people around the world have been disrupted in recent months, of course. So we have now rescheduled it for October 8th. It will be a virtual event rather than face to face. We're really anxious to showcase some of the rest of the leadership team. You know, the group on this call gets to hear from Paula and I with some frequency, but we've taken some strides to really bring on board some great new leaders, and it'll be an opportune to showcase them as well.

And yes, John, one of the big topics that we feel compelled to address and I think we'll be able to give some good color on and good insight around is this concern that some do have around exposure to sort of tech cycles and cyclicality that may have occurred in points in the past.

I think it's, you know, a longer answer. I don't want to steal too much of the thunder then either. But we're quite optimistic, actually, that we're going be able to convey that we've taken a lot of strides and we're continuing to take some additional strides to create new sources of revenue for the business and dampen any of that cyclicality that it exists in the past. We're still you know, we still do, of course, we're at the leading edge of testing and validating next generation technology. So it is something of a factor. But I think we're feeling quite good about the fact that we've taken a lot of steps building new recurring revenue streams in a way that should give everybody some comfort around that.

The second question around COVID, you know, and is it still holding back efforts around winning new customers. Yeah, I think the way that we've continued to try and stay customer focused, engaged with customers, I have to give the sales and marketing team some real credit and real props for the way we've gone about it. We've had to get creative and innovative in the way that we manage to stay in touch and stay close to our customers. I think things that weren't necessarily our forte in terms of digital marketing and online demonstrations and webinars and so forth, we really had to, you know, accelerate our use of those sort of tools to stay engaged with our customers. There are some different dynamics. I mean, customers have been, you know, available and we've been able to brainstorm with them on a lot of new ideas.

So, you know, we're still generating really nice new pipeline on a lot of interesting and creative topics that I think -- and it's logical and I think this is not unique to Spirent. It is just tougher in this environment to generate new relationships, you know. New relationships without the opportunity for face to face contact, they're just inherently more difficult. So that's true for us. I think it's true for everybody, but it's not stopping us. And, you know, we're continuing to very aggressively, you know, drive this this mantra of customer centricity, which is one of our strategic pillars. And that's, you know, both for existing and new customers.

Just around second half growth projection, Paula, do you want to chime in on that one?

Paula Bell:
Yeah, sure. Good afternoon, John. Yes, I mean, I think most of you will know Spirent in a normal year, the phasing of how we win and deliver our portfolio is always a little bit at the whim of customer central files [spelled phonetically]. The Q1 also was the smallest quarter, and H1 is always less than H2. So our Q4 waiting in high speed Internet, in particular, still stands as a deliverable in the second half. So and then we have this phasing [spelled phonetically] arrangement in the backdrop of the pandemic. So I think you're right. You use the word caution, John. We don't have visibility of all the moving parts, clearly. So, you know, we're still standing by our overall commitments of mid-single digit revenue. And we really have to see how the rest of the year pans out. As Eric said, we're quite cautiously optimistic on a number of fronts for the portfolio. So we're well positioned to see how we can work with our customers into those key drivers, which is, you know, [unintelligible] that and remain still in place for 5G, 400 gigs. So I guess we'll be able to give you more update at the end of Q3, John.

John Karidis:
Thank you. I just wanted to confirm, if I may, please. I totally appreciate in absolute terms, revenue in the second half is much bigger than the first half. I'm just trying to figure out whether you've just turned out seven percent growth in the first half. There is no exceptional reason for that. And there's no Spirent specific reason why the number would clearly be less than seven percent, apart from general caution about COVID-19. Just that, if I may.

Paula Bell:
Yeah, I mean, if we look at the phasing of the first six months, we start the year with an extremely strong quarter. You can see that from the quarterly trading update. And at the entrance of the COVID pandemic environment, if you will, we saw some softness during April and May and then a pick-up in June. So if you like, we haven't got -- we're still

working with data sets that are moving around, John. So Q2 was softer than Q1, if you will. So we need to understand the exit rate as we go into the second half of the year. And so it's just we'll have to wait and see in that regard, yeah.

John Karidis:
That's great. Thank you both very much.

Eric Updyke
Thanks, John.

Operator:
Thank you. Our next question is from Luke Holbrook. Luke, your line is now open.

Luke Holbrook:
Yeah, thanks for letting me on the call. I just have a couple of questions, if I may. One of them on the service assurance division. It seems great, it accelerated pretty strongly in the first half of the year. And I wondered if that was a consequence of the contract push up that you've seen from your U.S. customers that you talked about toward the end of last year.

Eric Updyke:
Yeah, so as it relates to life-cycle service assurance as a growth driver, it's one that, honestly, as we look backwards back into 2019, it hadn't sort of fulfilled I think our expectations or maybe the expectations we set, you know, externally in terms of growth. We remained bullish on the, you know, the premise that your next generation service assurance and active assurance is going to become increasingly important at the complexity of networks increases; and it certainly is with 5G as customer expectations increase, and as service providers are under a lot of OPEX pressure and need to automate a lot of their processes.

So all those factors were sort of the case and the investment case that we have around why this is such an important part of the business. You know, the additional sort of factor related to COVID is there's been a lot of new stress on networks because we're all operating in a different mode. So many of us working from home on Zoom and other calls all day, it's creating some new stresses on these networks.

So we finished Q4 of last year with a really nice, you know, order book that had built up right at the end of the year around service assurance. This -- and we continue with a really good momentum in our service assurance business, both in the lab and on the live side; so both the Landslide portion, which is lab related, you know, our 5G core emulator, as well as on the vision work side, which is sort of the life assurance play.

The thing that we're really encouraged about is, you know, while -- we've got some pretty good customer diversity across the company, actually, quite good customer diversity across the company. The service assurance space is one where we're a little bit more concentrated. And we've been working hard to add new customers and diversify that customer base. We made some really good progress in winning New Logos in the first half. They're still North American focused. So it's not a rest of world, you know, success to build a report yet. But it really is a broadening of the customer base, and it's not just leveraging the win that we've reflected on late last year. So, you know, we're adding some breadth to the portfolio in terms of customers as we move on down this path.

So hopefully that gives a little bit of a color around that one. But it was really a nice result for service assurance. And we're optimistic that the drivers that I talked about are, you know, very relevant as we look forward.

Luke Holbrook:
Fine. And just in terms of revenue trends that you see during the first half of the year. Can you give us kind of the direction of how it's performed pace year end or whether you have kind of a [unintelligible] just to understand where the movement was, because I think in the first quarter of the year your revenue growth was 12 percent. It seems like it moderated quite considerably in the second quarter. So any detail on that fund would be great.

Eric Updyke:
Paula, you want to pick that one up?

Paula Bell:
Yeah, sure. I mean, you can see the group order intake in revenues is similar [unintelligible] so a one to one ratio, and then that's playing out pretty much across all the segments in the same way at this point. Yes. And do you remember, as Eric said, the older growth we saw a good pick up for life-cycle assurances right at the end of the year, which had sent a very strong order book into this half. So momentum continues, particular in service assurance, as it will see a one to one ratio for group overall so far. Yeah.

Luke Holbrook:
Perfect. Thanks.

Operator:
Thank you. Our next question comes from William Kirkness of Jefferies. William, your line is now open.

William Kirkness:
Thanks very much. I've just one on sort of orders on another, again, a couple on the margins. And firstly, I think from a previous question, how did the order intake look perhaps in June and maybe July, if you know, versus April and May [unintelligible] week and months. And then around the margins: so the gross margin improved. So is that sustainable? And then selling and distribution costs were down in the first half, so I just wondered if they grow in the second half. [unintelligible] some areas are just still not likely to come back in the second half. And specifically, the benefit seems to be in LSA, where the drop to revenue growth [unintelligible] 100 percent. So I guess I'm wondering if you can hold that margin you saw in the first half in LSA in the second half.

Paula Bell:
So let me help you with that as well. Eric, you want to [unintelligible] around the orders phasing, first? That would be really helpful.

Eric Updyke:
Yeah, sure. I mean on order intake, April and May were softer. I mean, I think that's the short story. In June, you know, bounced back pretty strongly. So it's -- I don't think it's a huge surprise. You know, a lot of our customers labs were closed, you know, in those months. And it had the effect, of course, of delaying some decision making. But on the whole, of course, then second quarter was softer than first quarter. But, you know, our exit

rate as we got into June was looking quite a bit better. I won't reflect on second half. We're still looking back at first half. So, but only to say that, again, the sort of raw material that we have in the way of pipeline for deals is pretty robust and we think supports, you know, outlook for the full year, for the second half.

I'll let Paul speak to margins in a moment, but just on the SG&A fronts. Yeah, we did, you know, in terms of where we really were successful in moderating costs in the first half, most of it came to the, you know, the sales and marketing line. And there are a couple of factors.

You know, one, we did defer some commissions to the second half. So that'll hit in the second half. And some of the spend is really just -- it is a timing thing. We did a marketing effectiveness study and we actually made some adjustments to our marketing function. But we're investing back in that function. We launched -- we relaunched Spirent.com, rebuilt our website that launched July 31st, just a few days ago. And we're really putting a big effort around digital marketing. So we're taking a different sort of approach with our marketing efforts. And, of course, building up as well, you know, the services organization and services sales capability. So, you know, and we got some benefit, of course, from not traveling due to the pandemic. So all those had a has had a positive benefit, just on the cost structure in the first half.

But in general, we see all this sort of chaos and the strength and the good foundation we have as an opportunity to really invest back in the business and really try and set ourselves up for longer term growth. And that's the mindset we're taking. We'll, of course, be selective about where we invest. But we're certainly on the sales and marketing line, some of this is a bit temporary in a way, particularly for things like the, you know, the commission structure that's just deferred to the second half of the year and some incremental investments are making.

Paula, do want to speak to the margin question?

Paula Bell:
Yes, sure. And yeah, it closed at the 73 percent gross margin for the first half, which is exactly the same for the full year last year. You will see the increment half on half because as we were driving more software sales through 2019, plus the comparator, if you will, for the first half. People always ask me about the direction of travel of gross margin. I think 73 is a good number. Either we have the tailwind from increasing our software content, which is often driven by higher positioning sales are, indeed, lifecycle service assurance that should seem strong in the first half. But, you know, we are -- one of these areas we are investing in second half is building a central services management team, a whole new skill set coming into Spirent to support that revenue stream. That cost will build up in the second half. And indeed, when you bring more services, we'll be talking to you, of course, around about bringing a bit of a gross margin headwind. So net-net, gross margin at 73. That's a pretty solid number and a good one to model behind.

William Kirkness:
Okay, thanks very much. Just to come back them up on the selling and distribution costs. [unintelligible] 6 million or so that it was down. Is that the right number to think that comes back or [unintelligible] any part of it? And [unintelligible] explicitly or was a lot that related to [unintelligible]. I'm just trying to work out why the [unintelligible].

Paula Bell:

Right. You need to look at the cost [unintelligible] in one of two ways and not mix them up, because you remember our sales force is the global sales force; it's not allocated within each of the segments. That's not how we sell. So the cost structure is R&D, sales and marketing, [unintelligible] that's one lens. And the other lens, of course, is the amount we allocate for the shared cost out on a percentage of revenue basis.

So I wouldn't try to get too caught up in the operational leverage point of the half year because by the full year [unintelligible] fall out because we will re-invest in our marketing activities and services activities as we step through the year. So I wouldn't get too tangled up with that.

Yeah, we may be a few million benefit from travel -- that's a boost, obviously gets picked back up in the second half because it's legal to travel as much then [unintelligible]. But there is real investment -- I recognize we don't have a shortage of ideas in the business from our management team, a sense of what we can invest in in terms of [unintelligible] partnerships [unintelligible]. So it's a small number of moving parts. I just put a break in the presentation deck on slide 10, and that will give some more color in terms of the moving parts.

So this time around on sales and marketing is not one single item there. There is a number of reasons why that costs was [unintelligible] and we'll look to get on with some of those activities in the full year.

And then we're filling by the full year as well. If the revenue forecast pan out the way that it is sitting in our minds and certainly then the margins will -- they'll reshape themselves into the models that we normally see. And so [unintelligible] operating margins is certainly possible in what we aim for on a mid-single digit revenue view.

So no change to the overall. I think one of our difficulties is a slightly different set, looking at these statistics when we do a quarter on quarter. And [unintelligible] in terms of things moving around more than usual, if you will. So and that's why we give an overall outlook as remaining unchanged because we fully intend to invest in those areas in the second half. So not easy mathematically to follow all the moving parts that we're trying to give up more information in the slide that we have as well, Will. Yeah?

William Kirkness:
I love it. Thanks very much.

Operator:
Thank you. As a reminder, ladies and gentlemen, if you'd like to ask further questions, please select star followed by one on your telephone keypad. Alternatively, please use the flag icon if you've logged in via a web browser.

Our next question is from David Mulholland of UBS. David, your line is now open.

David Mulholland:
Hi. Sorry, I thought I was on mute. [unintelligible] that last question and the comment on the cost coming back in the second half. I just want to be clear, because if I look at that bridge you just mentioned, Paula, on slide 10, it looks like there's probably somewhere in the range of 5 million that was, you know, deferral rather than travel related between commission timing and sales and marketing. Of that, is this has to come back or as in in each programs

you are already committed to and the expense just delayed -- and I guess that might be the case for commissions, or is this something that, you know, you've still got some flexibility that you've got a bit of let's call it wiggle room? You know, costs you can still cut out from this year if things are hindered by macroeconomic or COVID issues in the second half of the year.

Paula Bell:
Yes, David. There is there is wiggle room. I think you probably learnt by now is that were pretty agile in terms of how we manage our cost base in the face of visibility of a pipeline and order book. So we are able to turn and move around this bend quite sensibly, actually. As you say, the commission timing is commission timing. It is what it is. So we are able to manage our cost base quite -- in a flexible way. So and again, as we mentioned, you know, we don't have the visibility as much as we'd like in a pandemic world on top line. So quite correctly, we can manage our OPEX sensitively to when we start doing our various initiatives and assessments for the longer term part of the business. Eric?

David Mulholland:
And then --

Paula Bell:
Sorry, I thought Eric might want to just chime in there.

David Mulholland:
Sure.

Eric Updyke:
You know, I think you said what I would have said that we do have we do have some flexibility there for sure.

David Mulholland:
Very much in sync. So just in terms of your -- just want to touch on one thing, because obviously there's been a lot of geopolitical tension going on between the U.S. and China. And it seems you've had very strong growth again in APAC, which has been a trend for a few years now. I know you've got some very sensitive -- you know, you point you to U.S. government business on one side, but also a lot of exposure to, you know, major equipment vendors in China as well. I just wondered if you could talk a little bit about how you balance that and how you manage that. And is there any risk there or is it, you know, well enough, I guess, siloed that that's not something we need to worry about?

Eric Updyke:
Well, I think it is -- I think we've managed it well, right? You know, I came into this role April 1st of last year and. And in May, the U.S. government put some sanctions on Huawei. We don't comment, you know, about, you know, the details of specific customers but I think it's fair to say we've navigated this quite successfully over the last year, plus. It has required a ton of diligence and effort with our trade compliance team. The rules evolved; they continue in some respects to evolve. And so it's a changing landscape that we really have to stay right on top of it.

So, you know, I think I'd be remiss if I said it wasn't a risk. I think there you know, there is a risk and it's something we have to stay vigilant on. But the thing that gives me confidence is the fact that we've been able to navigate it to date. And there are different constituent groups, as you point out. I mean, there's a good portion of our business that is focused on the U.S. government. I will say that the success we've had in Asia Pacific is not a single customer story and it's not even just a China story. And so we're also -- and it's a part of our strategy as well, is to do more across the rest of the Asia Pacific region as well. So in terms of, you know, there's all the things that we do directly, you know, with our Chinese customers and making sure we stay in strict compliance and so forth. But the other part of, you know, just how we mitigate it is trying to win more business elsewhere in addition to; not instead of but in addition to and that's a big part of our focus that we've ratcheted up in recent months across the rest the APAC region. And it takes some time, but it's something very much in focus for us.

David Mulholland:
And just coming back to one of the questions earlier in terms of technology cycles and where it gets a bit further into the 400 gig cycle. And, you know, the point was made, generally, we start questioning how long will it last? And, you know, when might it coming to an end? Now, I assume, given what you're seeing in terms of bookings trends, you're not seeing any signs of that yet. But just thinking more broadly, given what we're seeing with work from home and the need for, I guess, for older high bandwidth deployment, the networks. Is that something that you think might influence the length of this cycle or is it just playing out as per normal? You know, is COVID having any impact on that?

Eric Updyke:
Yeah.

David Mulholland:
Various associated changes?

Eric Updyke:
You know, I'd say the 400G uptick, it came a little later than we were projecting and expecting it. It really kicked in in the first meaningful way in fourth quarter of last year. So we definitely believe we've got a ways to run here and that it's frankly still early days with 400G. There's certain parts of the world -- you know, 5G is an important driver for 400G as well with, you know, the new network architecture, the need to build bandwidth, move more capability to the edge, you know, to support the ultra-low latency of 5G. And so there's certain parts of the world that just haven't really gotten so aggressive with their 5G build out yet. So, you know, 5G is being driven more in China and Korea and so forth in the U.S. But the rest of the world still needs to come along with the 5G build out, including a lot of Europe. And so is that kicks in, we think it will be a driver for actually 400G as well. So it's just one more reason why I do think you're right that some of the stresses, the different stresses on networks from the way we're all working these days can be a contributor. And so I think it's got a ways to go. Bottom line.

Davis Mulholland:
And final question for me, back to Paula. The gross margin strength that you saw in H1. Obviously, I would suspect it's been a bit of a shift towards software, which you mentioned yourself in H1. But is that -- is it something that's sustainable or has it just been caused by that's what we can sell, what customers can use right now. And then, you know, second half or even next year when we move back to hopefully more normal lab based environments. Does that come back on, you know, how much of this is just mix versus something -- a

temporary mix versus structural?

Paula Bell:
Yes, I think, you know, we're seeing this growing trend as our ability to grow the life cycle service assurance segment, and that's high software content, right? The more strides we make in that area, the software driver will remain strong. Our positioning product, in any event, is high software content. So that's a key driver of the software content. And [unintelligible] we went from about 22 percent to 28 percent between 2016 and 2019 of our portfolio. So we're definitely on a -- you know, a fundamental increase all over that time period.

But I think the more we're in the network environment, the more the software content will be a prominent part of our portfolio. So a question we ask internally is what will that make up look like three or five years' time from now? And that's something that we debate internally. But as long as the, particularly the assurance piece is growing in the network is going to bring with it software strength as well, which is good for margin, clearly. And yes, I think we'll have to wait to see how it pans out, but we certainly have a trend over the last few years, which is consistently growing in the right direction. We'll have to wait and see.

Eric Updyke:
I'll only add David, it is -- when Paula refers to, you know, the next three years and so forth, it is -- the push that I'm making is to drive the company to be more software centric over time, so we've not set any sort of external objectives around what that percentage ought to be. But in terms of the mix over time, I want to keep driving it higher.

David Mulholland.
That's clear. Thanks very much.

Operator:
Thank you. Our next question is from Janardan Menon of Liberum. Thank you.

Janardan Menon:
Hi. Hi, Paula and Eric. Just a couple from me. Going back to the OPEX and the margins, given that there's so many moving parts, what are you sort of aiming for in terms of total OPEX growth for this year? Is it that you would expect a revenue growth of, let's say, five, six percent and therefore you would be looking to grow your OPEX by around that kind of a rate on your 2019 figure? Would that be a reasonable way to look at it? Or would there be sudden moving parts that which would change that?

Paula Bell:
Good question. If we include the investors that we want to do second half, then I would be expecting the total OPEX to be round about just above inflation, say three percent -- three four percent would be what I would have in mind for the full year compared to 2019. Janardan. Yeah.

Janardan Menon:
So it's three, four percent for inflation and then the additional investments coming onto the second half.

Paula Bell:
No, that would be sufficient because we're behind [unintelligible]. So full year 2020

probably land in the range of three to five percent. More than 2019. Yeah.

Janardan Menon:
Understood. Okay. And normally when I look at your gross margins, your second half gross margins have always been or tended to be about 200-plus basis points above your first half gross margins. And to a previous question, you sort of said, you know, it's better to model it or assume that it's sort of [unintelligible] at about 73 plus percent. And so it's probably going to be stable at those kind of levels because you've got additional costs. So I'm just wondering the costs that you're taking in the second half, increasing the services, business, et cetera, investing in [unintelligible]. Does that go into OPEX or does that go into COGS? Or what parts of it go into OPEX and what parts of it go into COGS?

Paula Bell:
[unintelligible] cost of that would you say?

Janardan Menon?
Sorry, could just repeat that, Paula?

Eric Updyke:
I think that's what we was asking. Related to the services business, that was the question around where do the services costs go?

Paula Bell:
Oh yeah, right. Yeah. [unintelligible] our services business, the people that deliver the services on the ground, vehicles through cost to goods sold, which is why it ties to gross margin, but it then doesn't need any other product development OPEX allocated to it because it's not using it. So it's a different model altogether as we grow the services leg of the business. So higher cost at goods sold, that only will attract [unintelligible] and some sales and marketing not R&D. So it's a different model. And [unintelligible] Capital Markets Day, I'll [unintelligible] that, but it's small at the moment as part of the business. The gross margin strength will come from the portfolio mix. So in the first half, you know, we came into the year with a strong positioning order book, we've talked about the lifecycle serves assurance trends as well on software, that played into a really strong gross margin. And so, yeah. And then the back end of the year is always the tick up in the high speed internet, which is more hardware and software, right. So we've got those moving parts to think of as well.

But I'll try to give you more direction on Capital Markets Day is how the margins might pan out with the services business as it grows. But early days at this stage. But yeah, different model there.

Janardan Menon:
Thank you. And my last question is on the Landslide part of your lifecycle service assurance, which earlier has been doing extremely well. Just looking at the sustainability of that part, rather than Vision Works, itself, is there sufficient visibility? I mean, obviously, this is a function of operators, you know, putting in 5G chords, which this product is helping to test. Are most of your orders that currently from Asia and do you expect that to move more into Europe and other parts of the world into 2021? Can we assume that that part of the business will continue to grow at the kind of levels that it has been doing in the first half of this year?

Eric Updyke:

It's -- so the customer base around Landslide, it's quite broad based. You know, when we say we're more concentrated on Vision Works, it really is a different story. This -- we really believe we've got, you know, the undisputed best sort of core network emulator in the market. And I think it's proven by the way customers buy it across the world. So it's pretty broad based geographically as well. We did have really nice momentum continuing in the first half for Landslide. I think that is going to continue for the foreseeable future, but not forever. And so it'll slow down at a point. We don't see it, you know, falling off a cliff, but certainly we see the growth rate tempering. I'll say as we look out -- I'd say 12 plus months to a more moderate pace. As more of the, you know, a greater percentage of the world service providers have, you know, kind of validated their core networks. But there are a lot of operators that are just not as far along right now and still need to do that work. So it's a really successful part of the business. And I think it's proven that we've got a really competitive edge there just by the customer uptake we've seen.

Janardan Menon:
And the Vision Works, would you it would it be fair to assume that that goes the other way, that gradually that keeps accelerating over the next few years?

Eric Updyke:
Well that would sure be the objective. Yeah. And the biggest sign of encouragement, I mean, we had we have really, you know, some of the biggest, most demanding service providers in the world are our anchor clients for Vision Works, right. So we've -- that's always given us confidence. And the game has been to really broaden and diversify that customer base. We had some good success in first half in signing up new customers in North America. We have more work to do to continue to, I think, simplify the solution and make it more readily consumable, particularly for smaller service providers. But that's work that's very much on our radar screen and that we're undertaking and I think to the degree we execute on our plans there, it positions us very well to, you know, kind of keep moving, moving out into the more tier two service providers and so forth and I think having an even more compelling story for, kind of, the rest of world.

Janardan Menon:
Understood. Thank you very much.

Eric Updyke:
Sure.

Operator:
Thank you. Our next question is from Kai Korschelt of Canaccord. Kai, you line is now open.

Kai Korschelt:
Yeah, hi. Good afternoon. Morning, Eric. Thanks for taking my question. I had two. The first one was, I guess, as a follow up on the regional question earlier. So if I look at your North America sales, I think they're essentially flat or up a couple percent year on year end. Given the, you know, military positioning business probably has been pretty strong, it would suggest that underlying your sales to service provider [unintelligible] probably or, you know, seemingly declined year on year, which seems a bit sort of odd, you know, given the [unintelligible] investment cycle. So I just wanted to get a bit of a sense in terms of, you know, what exactly is this going on? If you could unpack sort of the situation in the U.S. or

among U.S. customers at the moment.

And then the second question, Paula, was on receivables, which I think had a big inflow in the first half, more than 50 million, which I think is pretty -- it's unusually high for your, sort of, seasonality. I'm just wondering if we should assume that most of that sort of, I guess, sort of unwinds or perhaps partially reverse in the second half, which would in turn mean that the free cash flow in the second half would be probably lower than the first half. Thank you.

Eric Updyke:
Yeah. So I think just on the regional peace and reflecting on North America and it being essentially flat, as you observed, Kai. I don't think it's quite as you might surmise, though, in terms of what's going on underneath. One big factor that has occurred and it's very much COVID related is the sales to sort of the U.S. government piece, particularly in second quarter, really slowed down. And a lot of the U.S. government and the labs of the defense contractors were closed. And it definitely had an effect.

So, by contrast, you know, China actually opened up and got back to business a lot sooner. So I think there is something of a COVID timing effect that contributed to, you know, some of the growth that we had -- the relative growth we had in Asia-Pacific and the relative flatness in North America. I don't know that it was really just a reflection of service provider weakness. And I think when we look ahead to the second half, you know, we're cautious -- you know, all of its cautiously optimistic, but we're quite hopeful that the U.S. government business gets back to a more normal clip.

And, you know, the 5G push is certainly a very relevant one, you know, for service providers. There is some caution that's being applied on behalf of some of our customers in terms of their spend patterns and so forth. But even as they look at prioritizing their spend, the stuff that is most important and they continue to invest in are the areas in which we're helping them. And it is, you know, their next generation technology, it is things like 5G. So even if some spend has been moderated in aggregate for many of our customers, the areas that we're focused on still, you know, are in the sweet spot of where they need and want to invest. So we think that bodes, you know, pretty well for us.

Paula, you want to speak to the receivables?

Paula Bell:
Yeah, [unintelligible] cash. You know, that would we've been working hard on cash for a number of years now, as you can see from the balance sheet. But, in particular, in this pandemic environment as well we were quite keen to make sure nobody paid late [unintelligible] and that didn't happen. Cash collections are extremely tight. And so, yes, it was extremely tight. But what we see with the working capital, we see a material reduction in the first half of the year. On slide eleven in my deck, it sets out the more easier way to understand cash flow, if you will. But we had a working capital reduction of 29 million in the first half and that compares to 27 million same period last year.

So the shape of the working capital movement is identical. And the reason why we have that big influx of cash at the beginning of the year is simply because we have a lot of deliveries in Q4 where the cash comes in beginning of this year. So the shape of the working capital movements is identical to last year. And I see the same shape to the remainder of the year. So, you know, last year, half of that unraveled in the second half. We see a very similar picture this year as we step forward.

Overall, though, I still would expect the cash balance to grow a little bit between now and the full year as you step forward. But hopefully that gives you a little bit more color to the shape of our cash flow as well.

Kai Korschelt:
Okay, great. Very helpful. Thank you.

Eric Updyke:
And if nothing else, I want to thank everybody for their participation and their continued interest and support of Spirent and look forward to speaking to you all again soon. Maybe even seeing you face to face again soon one of these days.

Thanks very much.

[end of the transcript]