THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SPT.L - Half Year 2014 Spirent Communications plc Earnings Call

EVENT DATE/TIME: JULY 31, 2014 / 7:30AM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Eric Hutchinson *Spirent Communications plc - CEO*

Rachel Whiting *Spirent Communications plc - CFO*

CONFERENCE CALL PARTICIPANTS

Nick James *Numis Securities - Analyst*

Gareth Jenkins *UBS - Analyst*

Robert Lamb *Jefferies - Analyst*

PRESENTATION

Eric Hutchinson *- Spirent Communications plc - CEO*

Good morning, everyone. Welcome to the Spirent Communications first half-year results presentation. I have Rachel Whiting here with me, CFO. And, of course, I'm Eric Hutchinson, CEO of Spirent. So if you'd just note the disclaimers in the safe harbor statement about forward-looking statements. Thank you.

So I think the key message that I'd like to get across to everybody today is that we set out an update to the strategy, a reorganization, at the back end of last year and these results really have some proof points demonstrating that we're on track, we're on the way. And what we're doing is producing some good results and interesting new solutions and we're building a foundation for the future.

And some of that positive progress is really represented by a key measure, which is how much business do we do? So you've seen that we were guiding for about 10% high-single-digit revenue growth on an organic basis. We're reporting 16% growth; that's 14% organic, 2% that's coming from acquisitions.

And if you look at our reporting segments, networks & applications' revenues are up 13%; wireless & service experience revenue up 7%; and the service assurance business, a 74% increase. That's clearly been boosted by the $12 million in delayed recognitions from 2013 and also enhanced by some revenues from the customer experience management acquisition, DAX Technologies, that we made earlier in the year.

The good news is that the underlying order intake for the Group is a positive at 104, so we've built order book in all of our businesses in the first half year. One exception being service assurance itself, but that business traditionally books most of its orders in the fourth quarter and then works down that order book through the first three quarters of any year.

Also investing in the business. Those investment plans are on track. We've got more to do in cyber security, but think of that as an upside opportunity when you're thinking about numbers for Spirent.

There's been a strong emphasis within the Company on customer service and support; putting engineers on site with customers. That's paying dividends. We are seeing win-back of market share and we're developing closer relationships and we're enhancing the solution sets that we're delivering to customers as a result of that.

And there really is a tangible feeling within the Group as I talk to people who work for Spirent around the world. It's very much the energy, the commitment, the enthusiasm is tangible.

We show key performance indicators. So, as I say, refer to the book-to-bill ratio 104, but that's on the back of a strong revenue growth. The 110 last year was revenue being challenged. The revenue growth referred to. Operating profit is up. The return on sales largely held its own, overall. A little bit of gross margin pressure; we'll talk about that as we go through the presentation.

The Company generates positive cash flow. We're down a bit against the same period last year. We've done some major investments in new facilities. We've taken business units and combined them into one facility in Frederick, north of Washington DC. So there's a charge there. We're also doing some more facility moves in the second half year and we're building state of the art labs to support our business.

And, as a result, you can see the growth in earnings per share.

So, with that, I'll hand over to Rachel who will take you through the financials. Thank you.

Rachel Whiting - *Spirent Communications plc - CFO*

Thank you, Eric. Good morning, everyone. It's good to see you all again. Looking, then, at the Group results in more detail.

As Eric highlighted, revenue in the first half increased by 16% compared to the first half of 2013 to $221 million, of which 14% was from organic growth and 2% from acquisitions.

In addition, and in contrast to 2013, revenue grew in each of our divisions, benefiting from a combination of improved market trends as some customers increased their capital spend, success with our new product developments and the recognition of the service assurance order.

We also saw revenue growth in all regions, particularly Asia Pacific, which grew by 22% over 2013, driven by strong demand in China, and in Europe, where revenue grew by 28% over a weak first half of 2013 as economic conditions improved in that area.

The adjusted operating profit of $20.6 million reflects the additional investments that we're making in product development and in sales and marketing, where we've invested an additional $10.5 million in the first half.

The effective tax rate that you see is 27.3% for the first half and we expect to have 28% effective rate for the full year.

The adjusted basic earnings per share rose by 23% to $0.025; up from $0.0203 in the first half of 2013.

So breaking that down into more detail and turning first to the largest of our three segments, networks & applications, which accounted for 47% of revenue in the first half.

Just to remind you, and Eric's going to go into more detail about the reporting segments a little later, networks & applications includes test solutions for everything to do with Ethernet.

Here, revenue grew by 13% compared to the first half of 2013, which was driven by strong demand from data center and service provider infrastructure markets, which were dominated by high-speed Ethernet and initial SDN/NFV deployments, driven by mobile traffic growth on core networks.

You can see that we maintained gross margin here, despite continuing pricing pressure from the network equipment manufacturers, particularly in Asia.

Also regionally we saw strong performance in APAC and Europe returned to growth with bookings up 38% over the first half of 2013 as the macroeconomic conditions improved and we saw spending increases across both customers and technologies.

Again, in the first half, we made additional investments in product development and in sales and marketing of $4.5 million here, which we expect to continue into the second half.

And the continuing improvement in activity levels in this division resulted in a book-to-bill ratio of 108, which gives us some positive prospects for the second half.

Turning, then, to the wireless & service experience division, which accounted for 39% of revenue in the first half.

This segment includes everything to do with solutions for functional and performance testing of next-generation mobile devices, predominantly smartphones, and includes our positioning business. It now includes Testing Technologies, the small German acquisition that we made in February this year, which makes software-based testing tools. It's also where the Radvision acquisition that we recently announced will sit.

Here we saw revenue grow by 7% compared to the first half of 2013 to $85.7 million, with 2% coming from acquisitions and 5% organic growth. This was driven by strong demand from device manufacturers following the release of 4G licenses in China and by strong demand from the VoLTE testing needs.

In our positioning division, although we saw strong performance in Asia and Europe, we saw delay being tempered in the US by delays in US Government spending.

The lower gross margin that you see here reflects strong growth in services revenue, which has a relatively lower gross margin, and overall product mix. But we expect to see some improvement in our margin in the second half.

The operating profit here again reflects the additional investments that we're making in product development and sales and marketing of $5.4 million and, again, that will continue into the second half.

This division also built order book in the period, reflected in the positive book-to-bill ratio of 107.

Turning to our third segment, service assurance, which accounted for 14% of revenue in the first half.

This division is about monitoring in the live network and also includes our unique field test solution for in-home testing. And this is where DAX, our customer experience management business, sits that we acquired in late February this year.

Revenue here grew by 74% as we shipped the large field test order for $12 million that was delayed from 2013. And this has resulted in operating profit up by more than 100% and a return on sales of 44.1% in the first half.

Order intake here was impacted by pending mergers in the industry that have caused delays in procedural processes and a temporary slowdown in investment. And, as Eric said, this business tends to build order book in the fourth quarter.

The acquisition of DAX contributed $3 million of revenue in the period and $0.9 million of operating profit, which is broadly in line with our expectations.

Turning, then, to look at the cash position, the Group continues to have a high conversion ratio of earnings to cash, which in the first half of 2014 was 1.9 times earnings.

Operating profit of $13.9 million resulted in $19.1 million of free cash flow, which was assisted by the release of working capital of $6.2 million, but more than offset by the investment in capital expenditure of $13.8 million. And, as Eric said, we've invested in a new facility in the US where we've spent $5.3 million.

You can also see that we have used $38.9 million of cash to fund the two acquisitions in the period and have returned $28.7 million to shareholders by way of dividend and share buybacks, which leaves $168.4 million on the balance sheet at the half year. And we will shortly be using about $25 million of that cash to fund the acquisition of Radvision.

Finally, turning to shareholder distributions. As previously reported, we have a progressive dividend policy and the Board has declared an interim dividend of $0.0168 per share, which is an increase of 10% in dollar terms on the interim dividend for 2013. And this will utilize about $10.3 million of cash.

At the beginning of this year, we returned $15.6 million to shareholders in share buybacks, but, as we've previously stated, in order to continue to maintain the strong balance sheet we're not planning to make any further buybacks at this point.

And, with that, I'll hand you back to Eric, who will give you a market update and an outlook for the remainder of the year.

Eric Hutchinson - *Spirent Communications plc - CEO*

Thank you very much, Rachel. I'll turn to markets and reporting segments and take you through some of the new product introductions and some of the investments we've been making.

So if I turn to the reported segments and markets, I've updated this chart. So the last time I showed you this we have a served market of around total -- total available served market of $2 billion. We've now expanded that with the acquisitions that we made in the first half year, so now about $2.2 billion.

Most of that expansion, of course, is in service assurance and you can see that we've got 10% market share there of a $450 million market; slightly higher growth rate than the other segments that we're in, because the customer experience management part of that is a high-growth opportunity for us.

In the other areas, we're really confirming our forward view of market growth rates. So, overall, about $2.2 billion market growing at an average of 7.5% to 8% on a weighted basis.

And you can see I've noted here the principal technologies that we're serving in the various reporting segments, but I won't go through that list line by line.

I gave you the vision at the yearend, which is to be the leading experts in test and measurement technologies and data communications markets. A broad vision. It's an ambition, but the key thing, what did it really mean in plain English, is that we're looking to gain market leadership through demonstration of our clear expertise and really focus on giving customers the solution to their problems, not just a device to go and generate test data.

So very much a different emphasis and we're doing lots of things to make that very real. And our strategy was through continuous innovation to get there and also to be recognized for ease of use in the use of the technologies.

So complex systems, but easy to use. That's a continuing theme across the industry. And, again, what does that really mean? What are we actually doing?

We're investing heavily in the business. We're taking and utilizing our capabilities, our inherent technology capabilities, into new areas, new markets, new verticals. And we're getting to do that by hiring good people, training the people we've got and, as I mentioned before, working very closely with our customers.

So with this grand strategy plan, we've set it out. Is it working? Is there any evidence that this is doing anything at all? And, clearly, the key measure is are we winning new business?

As I said, we were guiding to high-single-digit organic growth and we're reporting organic growth of 14% plus 2% from acquisitions and confirming that statement on high-single-digit organic growth for the full year.

We're investing in the business. We're taking that additional contribution and gross margin from the growth in revenue and putting that back into investments through the P&L account.

We're hiring people. We're funding developments. We are participating in more standards bodies. We're chairing the Cloud Ethernet Forum, for example. And we're also building closer links to university departments. That helps us build future knowledge and it also locks in a series of our future engineers, who will ultimately be our customers.

As I mentioned, focusing on customer service and support. So we've put a lot of money into putting engineers on site with customers and that's certainly paying dividends in terms of winning back business.

And, clearly, we're acquiring businesses in a very focused way.

So I look at each reporting segment and highlight what we are doing in each of those segments.

We've clearly established a leadership position in Ethernet equipment again. So we've caught up on 100 gigabit Ethernet where we'd fallen behind; moving ahead in some of those areas.

We've demonstrated that we have a working 400 gigabit Ethernet test solution. So we work closely with Huawei and Xilinx, who are developing the chips, and gave a public demonstration of that technology. That, in itself, has generated a lot of interest from the major equipment manufacturers and we've had very positive in-bound enquiries about 400 gigabit and also what we're doing on 100 gigabit and everything else as a result of that.

We've seen some key customer win-backs with Tier 1 equipment manufacturers where we'd seen a significant drop in 2013. We're winning that back and we're gaining share in the key Tier 1s.

We've demonstrated success in software-defined networking and network functional virtualization test. So we're selling virtual tests. We're selling that to a new set of customers and we have full support for Openflow switch and controller testing and VxLAN.

Our virtual solutions, we're winning business at the service providers who are looking to invest in NFV and other technology applications developers.

We've been winning awards at various shows; one highlight being the Best of Interop award for our Avalanche NEXT, easy-to-use test product for performance testing layer 4-7 and moving into security test.

And we've enhanced our mobile packet core test product Landslide by adding WiFi offload.

Also within networks & applications, we've set up a new business unit, if you recall: infrastructure test optimization. This is all about automation of test. We're seeing a strong adoption in that, so making systems easier to use, getting engineering efficiency.

We've got solutions targeted at continuous integration and focused on LTE interoperability; so both very hot areas in the market.

We announced a new solution, which is a next-generation automation platform, but it's a virtual platform. We've called it Velocity and it became the finalist at Interop against some very stiff competition. We'll be bring that to market as a product in the fourth quarter.

We've won our largest automated solution contract to date and that's going to be an enterprise-wide deployment of iTest for continuous integration in a software developer. And we've launched a new solution, a test execution engine we call iTest Play, and received our first order for that from a major wireless infrastructure developer also.

So lots of good things going on in this new business unit and we've seen very strong growth coming through. It's running at around about 5% of Group revenues.

In wireless & service experience, we've seen a push forward on LTE carrier acceptance solutions. We sold that into China, into the 4G service providers, and we're tapping into the ecosystem with suppliers who support those initiatives.

Voice over LTE, we're enabling that as commercial deployment begins. So that's a strong growth driver for us. We've certainly consolidated our technologies in that position. We've got underlying protocol development in measuring user experience for voice traffic over the 4G network.

And the order intake, the bookings in the first half year have exceeded the whole of our VoLTE test solution sales in 2013. So we expect to see more of that in the second half and as we go into 2016.

And we expanded the capabilities with the acquisition of the Radvision TBU, which we're just still working through on the closing of that; so hopefully within the next week or so.

And we've identified market opportunities into machine-to-machine testing and connected vehicle ecosystems for our wireless technologies; so, again, expanding into new market areas.

Also within wireless & service experience, our live test business, our service experience part of the segment, the Metrico Wireless acquisition we made a few years ago, we've launched new solutions; Quantum, which is measuring mobile battery life in the live network.

Battery life is an incredibly hard thing to actually measure or simulate in the lab, so you need to do it in the live network and that's -- anybody who has a smartphone constantly knows you have to carry a charger all the time. So a critical thing to understand how these things behave.

We also have a system AVS for reverse logistics on audio. What's that about? Well, subscribers have problems with audio on their smartphones. They contact a Verizon or an AT&T and they say: This thing is duff. Send me a new one. So they send you a new one. You send your old one back and it piles up in a big warehouse. How do you have a system that efficiently verifies whether the audio on the smartphone is good or not?

We've now got a very efficient solution that will do that for the carrier. If there's no fault found, it can be refurbished and sent back out to subscribers. If there's a fault found, then it goes back to the device manufacturer, which relieves the carrier of the costs related to that device. So it's very important to them.

And IPAnalytics is really enhancing the diagnostics on everything we do in the live network.

We've also won a very significant order from a large Asian carrier for their VoLTE launch, which includes products from both this division, but also the ITO business and the mobile packet core parts of network applications and the services related to that. So we are very enthusiastic about that win. That's a big step forward for us.

And the product Fit4Launch has replaced some service providers' in-house field test programs. So they're outsourcing to us things that they were doing in house.

And we've expanded our capacity as part of the investment in the capital expenditure in the new facilities.

Also within wireless & service experience we include our satellite navigation business, our global navigation satellite systems.

Vulnerability of the GPS signals and other satellite signals is very high. It's a weak signal. I've mentioned that in previous presentations. There are always a lot of good anecdotes of ships crashing into each other and airports being shut down and lots of cheap (inaudible) devices.

The military have systems to prevent this happening, vulnerability, spoofing and misdirecting the GPS devices, but those are very expensive. They're not commercial solutions. We have developed solutions that enable people to really test whether they've strengthened and enhanced their exposure to vulnerability.

The backdrop here is, as Rachel mentioned, we've seen weak levels of sales into the US market, primarily to federal government subcontractors where they've been constrained in their funding position, their spending. But we have launched some new products.

So we've got a high-end test product, the GSS9000. We're already the leader in the market. We've just put even more blue water between ourselves and the competition. It's much more scalable. It's a multi-satellite navigation system. It's easy to calibrate and set up and it's actually stimulating interest from existing users who were perhaps not even thinking of upgrading their system. So that looks good for the second half.

And the 6300M, or MI, is a commercial product, which is looking to make sure that we keep our dominant market share in the commercial market. And the SimSAFE product really addresses the vulnerabilities on satellite navigation.

Within service assurance you saw the Flex units being shipped. We know that the carrier wants to make further deployments of that across the workforce, but the timing of those orders we're not sure about. We are in negotiations on another phase.

Whether we get very much of that in revenue in the second half of this year is a question, because they've had an awful lot of units to digest and distribute across the workforce. But they will equip their entire workforce and we will take this product to other carriers and also multiple service operators using cable. The device includes WiFi technologies, which are appealing to other carriers, as well as the MoCA technologies.

We completed the acquisition of DAX, which is a customer experience business. And there we've booked our first data analytics application for a wireline carrier. So there's a wires carrier-focused data analytics product we've now moved into wireline. And we've expanded the scope of the products to include LTE and we've added a lot more enhanced reporting, which adds a lot more value to the customer.

That product, InTouch, we've now integrated with other Spirent products, notably Spirent TestCenter Live. Again, we're delivering that to a US Tier 1 carrier. And we've expanded all of the activities around that to position ourselves for further growth to scale the business.

The other things we're doing is we've got some internal startup business units. So we have the automotive business. Here we've married that with the TT Technologies in Germany. They produce test tools and protocols, which address wireless technologies generally, but they've got some specific capabilities in automotive and that's given us a lead into a major automotive manufacturer in Germany and the test house that supports all of our activities.

So we've got proof of concept going on there. That's really the key to winning a leading position in that test ecosystem.

So automotive is a very crowded market but, from our perspective, it is crowded with potential customers. There are very few competitors on test, particularly data test, in automotive.

On enterprise, again, another business unit that's in startup mode. We invested round about $2.5 million in that. That's flowing through the networks & applications business, so that's one reason why the trading profit there is perhaps lower than you might expect to see from what we're doing in the core business.

And really we're developing a new channel for enterprise, IT deployment solutions, and we've also built products you can download as agents from the website to run testing as a service. These are known as BLITZ for load testing on websites, ArmorHub, which is some basic security test capabilities. And our Avalanche product, which is our layer 4-7 and firewall test system is also on that site as a virtual test tool.

And we're starting to generate subscription revenues from people buying those tests. And that's delivered over the web. So if you have an idle moment, then you know what to do in the evenings. You can test your own website with BLITZ.

We're also investing for inorganic growth; so the acquisitions we've announced. I won't bore you by repeating their names other than Radvision TBU, which are the test tools for wireless, particularly Voice over LTE and IMS and key protocols across the market, which we're looking to take into other solutions.

And we're working on other negotiations for similar size acquisitions at present and, hopefully, we can close some of those in the second half year.

So Radvision itself, we announced that in July. Cash consideration of $25 million. Based in Tel Aviv; pretty hot area for both technology and other things at the moment. Profits of $2.7 million.

It's a complete development test suite for voice and video IP communications; so rich communications traffic. So you'll read about that being the future for wireless data technologies as your multimedia communications.

It enables the chip and device vendors and carriers to deliver their products to market faster and more assured quality.

And we're leveraging the key product, ProLab, leveraging the installed base with key customers on voice and video applications over LTE. And it really consolidates our position in Voice over LTE test. It's all about an intellectual property acquisition, really.

But the protocols business within Radvision TBU is an annual subscription basis, so there's a good solid part of that revenue stream comes through every year. And it's a software sales and service business.

The other thing that I'm looking at is a long-term business transformation for Spirent. So as we look at the portfolio, what the market needs and where the customers are going, it's all about virtual. It's all about delivering test in software.

So we are nurturing new channels, new customers, new segments.

We're looking at our selling processes, so we're looking at the way we sell. So it's a business case when we're looking for the type of infrastructure test optimization contract, which is really about efficiency and engineering or process or optimization of investment in 4G LTE infrastructure deployments for carriers, for example. So it's much more of a business case.

So we're selling added value. We're not just negotiating with the technical experts on bits, bites, data, deep packet inspection and all of those things. So we are looking to get high-level contact with customers through high-level executive contact.

And we're building models where we get recurring revenue stream. So an awful lot of our business, over 55% of our business in the first half year, is our new products or product sales, new and existing products, but new contracts for products, and that tends to be driven by a capital expenditure cycle.

So as we build up solutions that tap into operating expense, then we start to build up annual subscription and the licensing and start to see the software mix growing.

So if you go back a couple of years, software in the revenue was about 16%, 17%; it's now about 20%. Services businesses were 18% to 20%; they're now about 25%. So there is a slow transformation happening within the business.

So, by way of wrap-up, I think what we're doing is really laying the foundations for future and greater success. It's very much an investment year.

There are some growing pains on the way. We've got some product rationalization that we're doing within our portfolio on the security test. That's held us back a bit this year, so that upside opportunity will be something we'll start to see in 2015 rather than 2014.

Clearly in some areas, particularly Silicon Valley, the competition for talented people is very fierce, so there is a bit of scarcity there, which has constrained some of our activities in the short term. But it's all about delivering long-term strategic growth.

And, in terms of current trading, we're in line with expectations for high-single-digit organic revenue growth, supplemented by the acquisitions that we're making. So steady as she goes on current trading and investing for the future.

With that, thank you, and I'll open up for questions.

QUESTIONS AND ANSWERS

Nick James - *Numis Securities - Analyst*

Nick James, Numis. Couple of questions. First on the gross margin, I guess particularly in the wireless division, where it's down about 3 percentage points. I guess as that market's converged around LTE, it seems that everybody's got a bit more competitive because everybody's suddenly all on each other's turf. I don't know if that is an accurate characterization of the market and if these margins can improve or if this market's going to keep getting more competitive.

Eric Hutchinson - *Spirent Communications plc - CEO*

The wireless market last year was definitely one where we saw pretty fierce competition with some of our larger competitors dropping off test boxes for long-term loan or heavily discounted. And I think, in terms of a standalone test solution, that that will continue to be a characteristic.

What you've actually seen in the first half year is not so much the effect of that as the effect of the mix, where we've seen an increase in the services element of the business compared to product. As I look forward, our new products are much more software centric, so that should help offset that going forward.

We've also seen pretty fierce competition in the physical lay of the radiofrequency fader test market and that's also constrained margins a bit, but that's probably about 12% of our revenue stream. But it's really the mix effect of all of that.

Nick James - *Numis Securities - Analyst*

And how do you differentiate now in wireless device testing?

Eric Hutchinson - *Spirent Communications plc - CEO*

The key differentiation in the near term is the strength that we've got in Voice over LTE test and we've been selected by the Tier 1 carriers to provide that capability. And we're winning business in Asia Pacific, both with carriers and the device manufacturers, on that.

We still have strong differentiation on anything to do with a location test. So our strongest growth in the first half year in terms of new orders has been related to location test systems, which tap into 4G LTE.

Going forward, we see a test system that meets the needs of device-to-device testing and modeling the infrastructure of deployments on 4G LTE. That's much more of a virtual software test tool.

Nick James - *Numis Securities - Analyst*

Okay. Thanks. And I guess the follow up was just on service assurance, where you said the serviceable market's increased. I guess historically that has been quite a difficult market on timing and lumpy orders. Do you think that can change, looking forward?

Eric Hutchinson - *Spirent Communications plc - CEO*

At the moment, that isn't changing. If anything, it's got more exciting from that perspective in that multimillion-dollar contracts get stuck in a legal procurement process and don't get closed in the quarter.

So actually we did miss a few million dollars worth of bookings, order intake, in the first quarter. Good news is that we've got it all in July. So that continues to be lumpy. I think it will because most of these are project-based type of deployments.

As we go forward, we're looking to build systems that will be deployed across the data centers of carriers. And that will be more of a continuous deployment, once we get that going. But in the mean term it's lumpy, particularly from a quarterly basis.

Rachel Whiting - *Spirent Communications plc - CFO*

(multiple speakers) very lumpy.

Nick James - *Numis Securities - Analyst*

Thank you.

Gareth Jenkins - *UBS - Analyst*

Gareth Jenkins, UBS. So a few questions, if I could. I wondered, I'm not sure if I caught this correctly, but the percentage of new products in the mix, either in backlog or in revenues and how you see that changing. So when I mean new, maybe that you have developed in the last 12 months or the last six months if there's a -- help us understand how that will change going forwards.

And I just wondered, secondly on the acquisition strategy, you're developing into a lot of different new areas at the same time. From here, does the acquisition strategy center on improving what you've got in key areas or expanding into further new areas from here?

Eric Hutchinson - *Spirent Communications plc - CEO*

So in terms of the new product metrics, the easiest one to have to hand is that it will probably add about 1% to 2% for revenue growth in the second half year from the new product launches.

The challenge we always have is that we constantly reinvent ourselves, so we take existing products and we constantly add and enhance them. So is that new product or not new product? And it's very difficult for us to track it.

If I do a deep dive, round about 30% to 35% of the revenue comes from product solutions that we launched in the previous 18 months. That's typical for us.

The acquisitions focus has been very much about both enhancing what we've been doing in the wireless business, by adding capabilities and really giving us solid differentiation. And then the data analytics acquisition was really taking us into a new area of provision of the answers to customers' problems; so taking the data out of the test systems.

The things we're looking at at the moment that we're currently working on all fall into the enhancing what we've got. So I haven't found anything that I'm comfortable with that would support going into a new market vertical. And some of the incubation of the startups internally is really to get to understand and know those markets before doing any significant M&A.

Gareth Jenkins - *UBS - Analyst*

And just one follow up, if I could. You talked about win-backs. I just wondered are you winning back against Ixia because they're being disrupt -- or they've had some disruption at the moment? Which product areas are you specifically seeing win-backs in?

Eric Hutchinson - *Spirent Communications plc - CEO*

So the win-backs are primarily in network complications than they are with the Tier 1 equipment manufacturers and they are against our primary competitor, yes. And it's a combination of enhancing and catching up and overtaking on technology capability.

But the other key part to it is being close to the customer. So having engineers on site, responding to their requirements for test automation, re-scripting so that they can use Spirent test equipment as opposed to the competition's equipment and so on.

Robert Lamb - *Jefferies - Analyst*

Robert Lamb, Jefferies. I don't want to split hairs but on the markets chart that you showed at the 4Q, the wireless & service experience has come down by 1%, I think. It was just -- I think it was 9% then and it's 8% now. I just wondered (multiple speakers) is there a bit of rounding there or was there some moving parts in that analysis you could maybe talk us through?

Eric Hutchinson - *Spirent Communications plc - CEO*

I think what we've done is, in the current served market, the growth rate potential for the development test tool that we put out there, we've moderated our expectations of the growth rate in that part of the market. But watch this space in the second half year.

Robert Lamb - *Jefferies - Analyst*

Okay. And then in terms of the startups, I just wondered could you talk us through where the three of them are at in terms of getting to revenue and how we might think about that going forward in terms of years ahead or whatever?

Eric Hutchinson - *Spirent Communications plc - CEO*

So the revenue expectations for automotive are modest. They're in hundreds of thousands of dollars. Although I think, with the momentum that's going, we got the potential to book a couple of million dollars of incremental automated business that we wouldn't have had if we hadn't done that startup process. And thereafter, the internal plan would be to double that number and then see positive growth rates of 25% to 30%.

We would clearly like to do better than that but that really comes how rapidly we can really get that foothold and work it.

Enterprise, similar story. There we've got a more solid channel distribution. We've now got the product right for enterprise IT deployment. So whilst it would be a plan that delivers $2 million, $3 million moving up to $5 million, $10 million, there are some deployments there where you could see some surprising upside, because we are talking to some very large enterprise customers. So no promises.

Unidentified Audience Member

Maybe a broader scope question here, if I could. We're witnessing perhaps an architectural change in the networks with SDN, we've seen a move to virtualization and you seem to be on the front foot, perhaps ahead of the market there in some of the test cases on virtualization.

How transformative, and perhaps I'm using the wrong word here, could that be to revenue streams in the future? Maybe in contrast to how you've seen a step change from 3G to LTE perhaps not being as major a push as some might have hoped?

Eric Hutchinson - *Spirent Communications plc - CEO*

So I'll just comment on the latter point. The latter point is really intense competition as the world has gone to a global standard. So everybody but everybody is after 4G LTE. Highly competitive.

And you're right, the change in the structure of the industry in device manufacturers has changed the dynamics quite significantly.

The next big step change on cellular is really the rollout and hardening of WiFi deployment and small cell and tagging that into machine to machine and critical infrastructure. That will be a very significant change to that industry. And lots of our initiatives about investing are making sure we're in the right place when that wave comes through in the next two, three, four years.

On the other point, on virtualization, that's clearly the start of a very significant shift in the industry away from large-scale hardware test and development to deployments of -- can't think of the right word but agents in the virtual network.

So the challenges are conceptually quite different. It's about managing the orchestration of the provision of data-center capacity to your subscribers on the fly, when you might be switching that within the data center but you might be switching it across data centers.

Those are major challenges that everybody is tussling with and we are working closely with those guys who are developing that software environment to make sure that we work with them on the test solutions they require. I would think by 2020 that we'd be predominantly a software solutions test supplier.

Okay. I know it's a busy day for everyone, lots of reporting going on. Thank you very much for attending and I'll catch up with you later.

Rachel Whiting - *Spirent Communications plc - CFO*

I just wanted to let you know as well that we are holding a Capital Markets Day on October 8, so do save the day. Location to be advised.

Eric Hutchinson - *Spirent Communications plc - CEO*

Thank you, Rachel.
