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SPT.L - Preliminary FY 2017 Spirent Communications plc Earnings Presentation

EVENT DATE/TIME: MARCH 08, 2018 / 9:30AM GMT

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PRESENTATION

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Good morning, everyone, and thank you for joining the Spirent Communications plc Full Year Results Presentation for 2017. For the benefit of the people on the webcast, I'm Eric Hutchinson, Chief Executive Officer. I'm joined today by Paula Bell, our Chief Financial Officer. If you could please note the content of the Safe Harbor statement before we start the presentation. Thank you.

2017, we set out a number of priorities in our Capital Markets Day and the clear thing that we highlighted was our sharp focus on target markets to drive business growth and profitability. Part of that was making some rationalization of the portfolio and we've made some cessation of some product lines and we've made some divestments in the period. We said we saw the opportunity to accelerate growth in our Lifecycle Service Assurance business and also inside the security to our applications security business unit and we were looking for key strategic wins as proof points that we were going in the right direction to access the live test market and live production networks. Key for the life of Spirent is innovation, and we also said that we would continue to innovate with the leading edge and maintain market-leading positions. We have a lead in high-speed Ethernet, we are the leading supplier of positioning technologies in our satellite navigation business and we've been first-to-market with new product solutions, enhancements to existing products in the period and we'll talk about some of that and we've clearly expanded our footprint and engagement with Tier 1 service providers.

We have a strong financial and operating platform. You see we've increased profitability, we've driven significant cost reductions in the period, we've realigned the organization and we're undertaking a living talent review to develop our own people. The team has done a great job on cash management. So, we doubled the free cash flow generation in the year. As a [board], looking at our cash position, our balance sheet position, we've decided that we would make a special dividend distribution of $0.05 per share, and we have now moved to increase the final dividend after 4 years of no increases in dividend payments. So, setting the backdrop for a strong platform for the future. So with that, I'll hand over to Paula who will take you through the financial results.

Paula Bell - *Spirent Communications plc - CFO and Executive Director*

Thanks Eric, good morning all. So, let's start by looking at the key financial metrics for 2017 here. It's been a very busy year, advancing both our strategic and operational agendas. We have specifically focused our investment portfolio to match growth trends and reorganize our people resource and cost base to be effective and efficient. We built a strong platfrom to maximize earnings potential. So although our group revenue was level as we previously communicated, our focused growth areas performed very well. We delivered our imporvement programs, which materially improved both profit and opearting margin. So here you can see operating profit increased by 27% to $58.9 million and the overall group operating margin increased from 10% to 13%. We also outperformed our cash targets and doubled the free cash flow, as Eric said. Net cash increased by $32 million to $128 million. The overall strong financial performance resulted in a 43% increase in earnings per share. So, we are already seeing the rewards of our plans with earnings growth and further evidenced by improved cash in the bank. So therefore, as Eric said, we proposed a 5% increase in the full year dividend [with $0.05] per share special dividend.

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So, let's just run through the financial summary here. Revenue in 2017 includes only 6 months trading from our divested businesses, Device Intelligence and Development Tools, that's [about $6 million of revenue compared to $13 million] in the prior year. Excluding our Connected Devices segment, revenue grew 2.4%. Increasing software content such as security applications drives improved gross margin and that's now up to 71.5%. Despite cost inflation and FX, we can see a material reduction in our total operating costs. So therefore operating margin moved into the teens well up on last year. We focused on effective tax management and very pleased to report a reduced tax charge for 2017 and further reductions in 2018 will come from the U.S. tax reform. Therefore, [7.55] adjusted earnings per share up 43%. So our balance sheet remains strong. We not only enjoyed the strong cash flow, but our accounting pension deficit reduced by $11 million to just $2 million. And for information, March 2018 has only performed on next triennial pension review. So it was therefore timely to review our balance sheet and capital allocation policies and I'll come to those shortly and make the proposed increased returns to shareholders. So I'll put a slide here to have a look at our portfolio performance. Our reorganization to these segments have allowed us to focus on taking the right actions quickly, be it supporting our growth areas or managing costs quickly to mitigate decline in our Connected Devices segment. Our Network & Security segment includes our market-leading high-speed Ethernet testing, our positioning business and our higher growth security fiber business. So together with Lifecycle Service Assurance, these 2 segments overall have the potential to drive top line growth. [They have varying] growth rates due to our market position, market growth and our technology cycle. Connected Devices, which as you know is in a technology hiatus between 4G and 5G, so we are transitioning this business to deliver more value with enhanced products and service range, but this will take time.

First turn to the performance of each in 2017. So the Networks & Security, I need to unpack this a little bit for you. We saw flat revenue overall, so we delivered more than 20% growth in our smaller security business and Positioning also had a very good years as U.S. government spend give a good boost as they tackle their vulnerability challenges. So this offset the softness in higher speed Ethernet business and we explained at the half year, we were experiencing some delays as some of our largest customers moved faster to 400 gigabit test platforms, and although 100 gigabit continued to grow, that growth rate slowed. We did not reduce technology investment in this area. Hence the operating margin reduction. It remains important that we can serve the pickup in 400 gigabit requirements, which is gathering nice momentum to see the growth in second half 2018. So clearly we are delighted with the progress made in Lifecycle Service Assurance. We said it was second half weighting, which it was and with an important large order secured in quarter 4. We see the next flush of order placements in the second half of 2018 and we are delivering operating margins in the teens much faster than we anticipated. So our 2 growth segments combined, 2.4% revenue increase and more than 16% operating margin. As we transition our Connected Devices segment, we took many actions during the year. We divested non-core product lines and businesses, we reduced our operating cost base and we performed a strategic review to examine the best path for creating value and align the future technology with trends. So within these numbers, $5 million of the $12 million revenue reduction you can see here was related to ongoing wireless device testing to clients and that's actually slowed to about 5% and the balance due to the divestments made in the year. As a result, $9.6 million profit turnaround was delivered as you can see here. So looking forward, we look to maintain this absolute level of profit. Improvement from 5G developments will be after 2018. Corporate costs, as you can see here, showed some increase. We made some investments into our governance processes in the year including a new risk management function, a refreshed PLC board and investment in GDPR compliance. So we are building a stronger business.

Revenue bridge, as you can see here. So taking our Networks & Security segment first, as I mentioned, a strong growth in our Positioning and Security businesses offset softness we saw in high-speed Ethernet sales. So an overall almost neutral outcome. Lifecycle Service Assurance made demonstrable progress, revenue growing 10% and importantly made up from a number of multi-million dollar orders with key clients. (inaudible) Connected Devices and we can see here the impact of the divestments, which we made in June '17. So what underpins future revenue growth at Spirent. Our focus remains with our Lifecycle Service Assurance business. The service providers are driving hard towards network automation and we can clearly help them get there faster and more cost effectively, which offers potential for 2018 growth and 5G testing in the lab provides growth potential for 2019. In Security, we continue to invest in its higher growth area and for our high-speed Ethernet business, we see the 400 gigabit momentum building up as I said, quite nicely for second half orders. So keeping this revenue, I thought you might find this quite interesting to see, it's important to see how much of our business we have developed under the surface in recent years. In the last 3 years, we have replaced $50 million of revenue in our Connected Devices segment with growth from our portfolio where market trends are more positive and growing. Connected Devices represented 30% of our portfolio in 2014 reducing to 19% in '17. So we've taken action to divest those products and businesses where returns were less attractive. And just again staying with revenue, our diversification remains strong. The geographic portfolio remains more than half with U.S. customers and we saw very good growth in Asia in 2017 and particularly with some new customers in China and it remains that the top 10 customers represents around 40% of our revenue and not 1 customer has more than 8%, which is good.

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So let's turn to the focused cost management slide here and on operating costs. So as background, during 2013 to '15, investment increased. We built strong technology portfolio and developed truly first-class customer relationships and we said we would review our operating cost base. As you can see here, the operating cost base excluding FX has reduced $26.8 million since 2015, of which $16.7 million was delivered last year, 2017. Now this reduction is after annual cost inflation, which runs at about $7 million to $8 million per annum. So the real cost actions taken have removed over $40 million of costs in the last 2 years. We did this by implementing a portfolio review and took action to exit certain business and product lines. We also employed sales external benchmark experts and as a result, we restructured our front line sales and support operation and revised our sales remuneration policy. We've also brought in new expertise to complement our growth strategy. So over the last 2 years now, we've removed over 200 heads, more than 10% of the staff base. We are much more right-sized, we have our resources allocated to our most critical technology investments and our sales staff matched to our key customers in growth businesses. Exceptional costs relating to these activities were $6.7 million in 2017, $4.8 million in '16 and payback from the investment has clearly been very fast. So if we look forward into 2018, we plan to hold our cost base level-ish. We have our annual [payroll] inflation to mitigate and we are looking at opportunity for driving engineering capacity release so we can create investment or cost saving choices. We were carving out this approach of course as we'll always consider business opportunities for investments at future growth streams.

So here you can see the operating profit bridge. We drove increased gross profit from Networks & Security and Lifecycle Service Assurance and then we can see the benefit share of the cost reduction actions. I've split the cost base details out here. The savings in 2017 from the actual staff reductions totaled $28 million, less the cost inflation, less [some] increase of bonus costs brings us back to $16.7 million mentioned earlier. We then see the impact on gross profit of the divestments and decline in Connected Devices. For FX, we saw some benefits in 2016, which reversed in 2017 and as a company mostly trading in dollars, for the cost base mostly in dollars, we are only really affected with the dollar/sterling transactional exchange exposure simply due to a small part of our operations being in the U.K. So to summarize, overall profit rose 27% to the $58.9 million.

Tax, as I said, a busy year. So in 2017, we managed to reduce our effective tax rate to 22%. In Q4, we secured approval for U.K. Patent Box benefits and the divestment of loss-making entities also benefited our rate. So now turning to the U.S. tax reform, some good impacts for us at Spirent. The tax rate changed 35% to 21%, reduced the value of our deferred tax asset by $7.9 million. So we dealt with that at the end of 2017, then from the 1st of January, we see the benefit [FX] in our group effective tax rate. For information of the key elements of the new U.S. tax reform, as impact from Foreign-Derived Intangible Income rules, not yet fully formed, I remind you, that provides a benefit recognizing income from foreign sales. Now this benefit actually mitigates the removal of the original domestic production activity deduction benefit. So our best estimate is 17% going forward, a good reduction, benefits EPS by around 7% and improves cash. So we'll continue to monitor and update if any changes in this area affect us. Cash, so we are delighted with our improved cash flow and conversion. The key variant you can see here is the working capital improvement. We are focused on our cash collection processes during the year and stock levels have reduced. We held some provisions of bonus and restructured costs at the year-end and these will be paid in 2018, but do expect some working capital increase in '18. We spent less on CapEx $13.5 million. So together with improved profit, we closed cash $128 million, up $32 million. So following the company reorganization last year, I took the opportunity to restructure the global finance function bringing in experienced finance directors to support the business, seeking increasing value from investments, resource and of course, translation of that to cash in the bank. So cash conversion was 122% in 2017, but do not assume that we can do that every year, of course.

So on the back of the strong earnings growth and the cash growth, we are proposing to increase the full year dividend by 5% and the final dividend will therefore be [$0.024]. With a very strong balance sheet, it was also time to set out our capital allocation policy. We have had a long history of experience in this technology sector and its cyclicality risk, so we therefore carefully reviewed our working capital requirements and its timing and in turn we will continue to maintain a positive cash balance to manage the business going forward. We will of course allow flexibility to support acquisitions when we need to do so. So therefore we plan to return $30.5 million by special dividend, which is [$0.05] per share and that'll be paid with the final dividend in May, a total of [$0.074] per share.

So summing up really, I think our financial model is really clear. We are being more precise where we invest, we choose clear growth vectors where we can compete using our differentiators and have strong customer relationships. Essentially, we see upper teen margins in our focused growth segments, we are demonstrably managing Connected Devices and returned it to profit quickly and the cost base has been reshaped and this offers potential for operational gearing as we grow. So I think we continue to have a clear approach to driving our earnings growth. So I shall now hand over to Eric, he'll provide more color on our proof points in 2017 and the potential we see.

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Thank you, Paula, for that clear and comprehensive review of the financials. Let me turn to review the performance highlights from 2017 and present how we see the business opportunities for Spirent in the coming years. For those of you who managed to get to attend Mobile World Congress last week, you saw the excitement and the business opportunities across the communications industry driven by the new services and applications that 4G and 5G mobile networks enable. There's tremendous potential value creation from augmented and virtual reality as represented by this millennial on my slide, [our] new costume going forward. I showed this slide on the Capital Markets Day. Smarter future will include many innovations that will revolutionize how we work and live and how we travel. We can anticipate fantastic productivity gains and new sources of revenue from smart industries and enterprises. We could all imagine better homes when they are optimized for our connectivity, security, energy efficiency and entertainment and we look forward to smart cities to keep us safe and secure and smart energy, smart water supply, smart waste management systems and we want our transport systems to be interconnected and coordinated. We want sophisticated traffic management to reduce traffic jams and pollution.

The smart future depends on fast and secure connections. They have to be safe and secure, and of course, all of this has to be delivered in an economic way. We have unprecedented opportunity to develop and manage the devices, networks, services and applications to deliver this smarter future. Our industry is uniquely positioned to provide the robust communication systems that enable this smarter future. We have to develop and manage a communications infrastructure with extreme connectivity, high performance and uncompromising safety and security, that's the challenge and that's our opportunity. At Spirent, that is our focus, it's our core direction and it's our opportunity to drive growth. We help our customers develop and connect their devices to the networks and to develop and connect their equipment and software to build new networks and services. We measure and optimize the performance of devices, equipments, networks, services and applications to ensure they satisfy their requirements and expectations and operate efficiently. We test security products and applications to assure they're resilient to cyber security attacks.

For developers, we focus on accelerating their time to market, reducing the time and cost to develop and launch products and networks. We provide a comprehensive assessment of the performance and security such that developers can deliver high-quality products and services and they protect their brand and their reputation. This has been true throughout our long history in the business, it's still true today and it will be true in the future.

For operators, we're focused on radically reducing operating costs while helping them turn up networks and services faster than ever before, troubleshoot and fix their network problems more efficiently than ever before, measure and improve network performance more comprehensively and understand their customers' experience with greater insights than ever before. As we look to the future, our primary aim [ought] to be automate testing and deliver autonomous service assurance. We have to automate testing to realize the smarter future. For example, testing in the future will be created automatically from the specifications laid out and also the feedback on real-world observations. In the short-term, we make test engineers radically more effective. In the long-term, we should be able to remove the human from the job. We will automate service assurance. We will leverage our core competencies in test methodologies, active tests, analytics, and automation. We'll explore and apply new technologies such as virtualization, artificial intelligence, machine learning and block chain. At Spirent, we will focus on delivering autonomous service assurance. With these game changers, we'll help our customers transform their networks and businesses and they will certainly outperform their competition and outperform their customers' expectations.

Let's have a look at the business opportunity. Consider first the test automation market, clearly its big, its growing and there are lots of challenges and that's good for Spirent's business. We have products and services today, but we will continue to invest in new products, new services and in our specialized sales force to automate testing.

Next, let's consider the network functions virtualization market. It's also big, it's also growing, but there are lots of challenges, but as I said, that's good for Spirent's business and again we have products and services today and we'll continue to invest in them and with specialized sales force to deliver NFC service assurance solutions. In fact, there will be much more investment made in autonomous networks. A recent report estimated the market will grow around about 50% a year, heading that way, to about $17 billion globally by 2025. Several network trends are disrupting our industry and how we develop devices and equipment and operate networks. Enterprises are increasingly adopting the cloud to meet network performance demands. Virtualization will allow enterprises to introduce new services flexibly and quickly while driving down costs to operate and manage their networks. Spirent is well positioned with solutions to help test implementation, benchmark performance, assure the service in the

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physical, hybrid and virtual networks. As the industry drives towards autonomous networks, we will test and validate the new equipment, the networks and provide autonomous service assurance systems for service turn-up, troubleshooting, and optimization.

Undoubtedly, artificial intelligence and machine learning will unlock radically new ways to operate and manage networks, so we continue to innovate here and are exploring and anticipating customers' needs in these areas. As manufacturers and operators look to streamline the introduction of new devices, the equipment and services into the production network, we are among the few suppliers in the world who have the expertise and experience that can facilitate the transfer as we test products in the laboratories and then move those into the network and we provide feedback on real-world conditions from network to network back into the development laboratories to troubleshoot development. We're positioned to satisfy our customers' needs and grow our business in this evolving environment. These challenges represent the opportunity for Spirent today and in the long-term. So our business strategy can be simply stated as firstly, we are the market leader and we will continue to invest to stay ahead in high-speed Ethernet performance and in positioning technologies for satellite navigation and its vulnerabilities.

We have focused and invested in our Lifecycle Service Assurance business. We have delivered revenue growth, improved profitability and won some landmark deals in 2017. We expect this momentum to continue in 2018. This business has sustainable long-term growth and profit potential. We believe the combination of security and performance testing is essential and we've made significant progress in building our security business and will focus and invest in expanding the customers we serve to establish a strong reputation in the security test segment.

As we said on the Capital Markets Day, moving into 2017, we've reorganized the business to have a sharp focus on our target business opportunities. In the development market, we're focused on building the right products and services here as well as investing in the expansion into the live operations. There is a bit of a fuzzy line between the 2 where there are some overlaps in the segments, but they are slight and they don't detract from the business focus.

Turning to our Networks & Security business, as I said, we remain the leader in high-speed Ethernet performance test. We participated in high-profile first-to-market demonstrations in 2017 and I'll highlight some of these shortly as vendors transitioned to 400-gigabit projects for development, they deferred some spending and our Ethernet performance business declined slightly in 2017, as Paula highlighted. Let's look at our Ethernet performance business more closely and I'll come back to the other parts of the segment later. Our Ethernet performance business has had a track record of performing on a long-term growth trajectory over the last 5 years. We're showing the trend line in the business here on this chart on the left. We had a positive spike in business in 2016, much higher than the previous trend as vendors invested heavily in new laboratories around 400 -- 100-gigabit projects and we won key deals and gained market share. Our vendors have transitioned their planning to 400-gigabit developments. They deferred some spending, which resulted in a slight decline in our 2017 results. We believe that total market spending in Ethernet declined slightly in 2017, but also that we continue to gain market share extending our leadership in the Ethernet performance per segment.

Looking forward, we believe we are best positioned to capitalize on the 400-gigabit projects and all of the variants in high-speed Ethernet evolution in the future as shown on the chart on the right as we had high-profile demonstrations and we won most of the early 400-gigabit deals in 2017 forming a good platform for the expansion of scale investments in the latter half of 2018. We participated in several high-profile first-to-market demonstrations. New H3C in China demonstrated the industry's highest density 100-gigabit Ethernet data center switch performance with an unprecedented 768, 100 gigabit per second [boards]. China Telecom, Guangzhou Research Institute and Huawei verified 400 gigabit per second Ethernet short and long-range technologies. In August, we worked with O2 to validate the WiFi network performance and capacity of the Coca-Cola London Eye before the launch of their new smartphone application. The London Eye operator wanted to ensure the infrastructure will provide an excellent user experience for their new visitor app. [We did, it does] and the app is bringing interesting information to our international visitors about the surrounding landmarks.

If I turn to Positioning and our satellite navigation business. In June, we were selected as the global navigation satellite system test system vendor for [European Union's] TREASURE project. The aim of the full year project is to provide instantaneous and high accuracy positioning anywhere in the world, exploiting different satellite systems operating together to provide users with positional accuracy of a few centimeters. By 2020, Galileo, the European GNSS system will be fully operational and provide positioning data, as I said, unprecedented accuracy. So coming back to our Networks & Security segment, we extended our leadership position in global navigation satellite systems including vulnerability detection and assessment. In 2017, we again secured important deals, as Paula mentioned, with the U.S. government and won business across various commercial segments.

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We grew our security business over 20%. We are the founding member of the industry group, NetSecOPEN, which focuses on defining new open standards for testing enterprise network security performance. We also earned global CREST accreditation for penetration testing. U.K. based CREST as I'm sure you know is an accreditation and certification body which supports the information security market.

Let's turn to Lifecycle Service Assurance. Here, as Paula reported, we grew revenue 10%, improved our operating profit to $18 million, 16% of revenue, an improvement of 5 points over 2016. We secured [15 deals of over $1 million each totally in business total of about $50 million] in 2017 and this is solid evidence our strategy is working. We expanded our footprint in the largest 3-tier -- 3 largest Tier 1 mobile operator customers.

We won 4 new deployments in Tier 1 mobile operators. We enabled network operators to rapidly onboard and proactively assure critical virtual mobile and IoT services. In one deployment, our VisionWorks product solution accelerated service onboarding by automating [turn up] verification of virtualized LTE enhanced packet core functions. In the second deployment, VisionWorks monitors the quality of business critical, mobile services that terminate in the enterprise customers client networks. And yet another deployment, VisionWorks provides proactive and automated troubleshooting analytics for identifying, prioritizing and resolving customer experience issues. The network operator shifted away from manual problem resolution driven by customer complaints to proactive automated resolution resulting in better customer experience at much lower cost. And the fourth deployment, VisionWorks dramatically accelerates identification and resolution of service issues such as poor data throughput for mobile operators delivering unprecedented ability to proactively test service quality across the end-to-end mobile network and correlate the results to isolate the root cause of service issues.

We also participated in several high-profile demonstrations. At the TM Forum Live in Nice in May, we demonstrated rapid service innovation in virtual networks. In the Catalyst project, which was sponsored by AT&T, Orange and TIM (Telecom Italia Mobile) and working with Huawei, IBM, Infosys and Tech Mahindra, we developed and demonstrated the automated validation of service enhancements in virtual networks using VisionWorks. The project demonstrated how NFV and open interfaces enable radically faster innovation with fewer resources.

At Mobile World Congress in Shanghai, Spirent and China Mobile Research Institute demonstrated automated testing for virtual core networks. The demonstration was part of a joint program to develop a methodology for automated testing of the functionality and performance of China Mobile's telecom infrastructure cloud. The system will fully automate testing of services in operational virtual core networks and will be part of the complete virtual core network environment built by the institute. We remain the leading vendor for mobile test systems for the development and system testing. These test systems have also been deployed in the network, which is solid proof of our capability to accelerate the transfer from products from the laboratory into live networks. We had a solid performance in 2017, we have positive momentum for 2018, although I'd anticipate that the seasonal mix will be weighted again towards the second half.

We provide solutions for both developers and operators in Lifecycle Service Assurance. VisionWorks includes solutions for customer experience assurance, regulatory service assurance and transport service assurance suitable for our virtual physical hybrids networks. Our customers have realized tangible economic benefits, which we're sharing across the bottom of the slide here. I'll just comment on 2 or 3. A Tier 1 North American operator reduced the average handling time for complex trouble tickets by 40 minutes resulting in annual savings of $30 million, A Tier 1 North American operator automated their small cell back haul turn up validation resulting in a 10-fold increase in small cell deployments. And a network equipment provider realized an 80% increase in testing workflow efficiency by automating their regression testing for new releases. We have a track record for delivering high-impact financial benefits.

So let's turn to Connected Devices. Although the market continues to consolidate, we have a strong business turnaround, as Paula reported, improving our operating profit by $9.6 million, resulting in a positive operating margin of 6% of revenue in 2017. We've released the Spirent Elevate IoT Device Test Solution, a new cellular test solution designed to support the Internet of Things applications, including end-to-end cloud server connectivity, security vulnerability assessment and battery life measurement. We won key deals with our new Channel Emulator with this unprecedented scalability and modularity for wireless RF testing and support for 5G wireless development.

China Telecom selected our Umetrix voice solution for their handset voice quality call testing. Our Umetrix voice solution was voted VoLTE Innovation of the Year at Telecom Asia Readers' Choice & Innovation Awards in Singapore and we demonstrated enhanced voice services with China Mobile at Mobile World Congress. This EVS codec is increasingly being deployed on mobile devices as global operators recognize the improvements in speech quality for their customers and efficiencies gained in managing network resources.

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Now we look at the 5G market. We are positioned to capitalize on the emerging 5G wireless business opportunities. We have products right across Spirent portfolio, all of our business segments will be positively affected by the development and operation of 5G devices, networks and services. We have 9 5G solutions available today and we are working closely with industry leaders and we've had 5G public announcements with Nokia and China Mobile in 2017. This diagram shows the breadth of 5G opportunities from device testing through to the core network testing and service assurance. The 9 blue boxes show the solutions we have already available and we've already sold these solutions to customers in 2017. You can see that 5G is not just about device test. It crosses our whole portfolio and we will expand our technical expertise, test methodologies and innovative solutions for 5G in the coming years. We've been working hard in 2017, as Paula said. So let's have a look at what was done on operational excellence.

We believe the sharp technology focus drives our competitive differentiation and we have decided on these strategic focus areas. We divested or reduced the investment in other areas to optimize the investment on our target business opportunities. In 2017, we benchmarked, as Paula said, all functional areas and set targets for efficiency improvements and throughout the year, we realized $28 million of operational cost savings. As our people are essential to our strategy and success, we launched an extensive talent management review and development initiative, which will be continually ongoing. As we look ahead, we will continue to streamline and standardize processes, focus on engineering productivity improvement, invest in our specialized solution sales organization and in our key account management. We believe there is significant business opportunities in supporting our current top accounts.

As we look ahead, we'll retain our sharp focus on our target markets. We're investing in the right growth areas to benefit from the market trends that matter most to our customers. We're focused on automated testing and autonomous service assurance solutions. We will invest in expanding our footprint in production networks. We will build on our growing position in cyber security testing and we will develop our product offering in 5G wireless and invest in new 5G solutions. We will continue to innovate to maintain our leadership positions. As I said, we are the world leader in Ethernet performance positioning and now mobile infrastructure testing. Key account management, we are focused for 2018, and there are large business opportunities in our top accounts as we meet their current and future needs. We're investing to position Spirent for the next cycle, specifically 5G wireless, Internet of Things and autonomous vehicles. We have a strong financial and operational platform on which to build. 2017 has established this firm platform to truly realize Spirent's potential. And we're focused on continually improving our productivity. Our engineering is the lifeblood of our business and we remain focused on optimizing our operational effectiveness.

By way of summary, we had solid traction in 2017, we secured strategic wins in our Lifecycle Service Assurance business with our active testing and [legacy] solutions as evidenced by our strategies working and delivering revenue growth of 10%. We grew our cyber security revenue over 20% and we've founded NetSecOPEN to support open industry test standards for security. As we said we would at the Capital Markets Day, we focused our people and investments on attractive opportunities aligned to our customers' critical business challenges and we delivered strong earnings and cash generation growth.

Looking forward, we'll see further 400-gigabit Ethernet test deals weighted more to the second half of the year based on our customers' [plannings], headlines that they've given us. We'll expand our footprint and grow our business with our service assurance solutions in production networks, we will capitalize on the emerging investments in 5G wireless. We'll strengthen our operational and financial performance to drive earnings growth. In short, we will deliver the smarter future, which gives us confidence in seeking further growth in 2018. Thank you for your attention. With that, I'll open up for question and answers and discussion and as we're broadcasting, please would you say your name and your company. Thank you.

QUESTIONS AND ANSWERS

Lee John Simpson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Good morning, everyone. Great set of results by the way for what its worth. So its Lee Simpson from Stifel. A couple of questions if I could. Maybe to kick off with 5G, Slide 35. So it was -- first insight for me as to how you're thinking about this space and certainly MWC was a bit of a hype cycle around 5G, on both [Naty and keys] are talking about testing on new radio already and it looks as though you're more a service assurance play with 2019 as your landmark year, is that the right way to look at it?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Probably the right way to look at it. We have got some early products around the new radio. Our Channel Emulator fader product addresses the needs they have for very large-scale, multiple-input, multiple-output over the air testing in chambers. That's where we're seeing those opportunities today. So, it's -- our investment is really around the network elements, the devices and the roll out in the client network and certainly we are resonating with the carriers who are looking to deploy the bench -- the mesh to support 5G cellular base stations that have much closer geographical [0.5-kilometer apart] compared to 3 to 5 kilometers for a 3G, 4G base station.

Lee John Simpson - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

Maybe if I just touch on 400 gig, can you give us a size, I mean relative size perhaps to 100 gig and what the cycle will look like insomuch as if it starts to roll up in second half next year, does it get to peak in 18 to 24 months' time, is it a sizable market versus 100 gig. Any color you could give us?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

It most certainly is of the same scale as the 100 gig market, maybe bigger. We see that the ramp-up of the [port count] that you need, full-scale testing that's going to be starting. As I said, our major customers have told us when they are planning to invest during the second half, so [we'll] then ramp-up through 2019 into 2020. So we're already talking to customers about their requirements for terabit Ethernet testing, the terabit switching. We've done some large-scale demonstrations with customers on their -- they are planning around that. So for me, the market continues to move apace. [We see] the port count on 100 gigabit is still very high. So the price point has moved down and that's one of the reasons why you see the revenue getting squeezed, but the scale of testing required and is still really increasing exponentially as data consumption is increasing exponentially, you can't have one without the other.

Francois Bouvignies

Hi, this is Francois Bouvignies from UBS. I have Just a couple of questions, the first one is on 400 gig, just a follow-up on this. When you say that H2, you will see the impact of 400 gig, do you see any risk of further delay like any of the technology that could maybe slow down the ramp and what is the evidence that you have that it will come into the second half and is there a risk that like 100 gig, the cycle was much shorter than you anticipated in terms of investments, that's the first one. The second one is maybe more for Paula. When we look at '17, you did obviously a very good work on the cost savings. Do you have still left to do in '18, I mean if I look at the pipeline you have, if you have 400 gig coming up, probably you will need to invest for this ramp, 5G is coming in '19, do you need to invest beforehand as well a bit and the Connected Devices you have less room than the other divisions. So I'm just trying to understand how you can get like a flattish operating cost environment with the pattern that you have?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Okay. So on 400 gigabit, as I say, its against the detailed planning by the major investors in developing 400 gigabit capability. There's always --

already been a bit of a slower start than perhaps anticipated during 2017. The competitive landscape is certainly such that [though] extremely unlikely that you'd see further delays and we are already supplying 400 gigabit test systems to bare-metal switch developers. So things are moving ahead quite rapidly now. We've definitely won business with key developers. So, they've done their initial proof of concepts. They've done their initial setups, they're now turning that to scale development. It doesn't make any sense for them at all to delay. If they delay, they will definitely miss their market opportunity. One of the things just anticipating, the answer in the -- what do we need to spend our money on, what's happening below the surface is that we're focusing our teams on developing 400 gigabit capability, looking at taking that towards terabit, but we're looking at developing the requirements for mobile operators and developers around 5G wireless. So we don't necessarily need to increase our absolute spending to do these things, we'll be focusing our resources on the key growth areas. Paula?

Paula Bell - *Spirent Communications plc - CFO and Executive Director*

Yes, just to add to that, we've done a lot of work in 2017 anyway and so we are not starting from scratch at this point. The key activities going on in our engineering environment in the last year has been really to focus on what are the guys actually working on, what do they not need to work on and redirect the assets. So that gives us some comfort that the cost base does not need to materially increase at all to fund the future investments, its just one of really strong focus environment now. So, yes, I mean 2017 has been a year of really focusing on the sales side. We moved from that into engineering capacity release, we do think there is more room from cost effectiveness from our footprint, (inaudible) processes and such things like that, but we are not starting up our investments on 400 gig and 5G now, we've been doing it for some time. So it does feel quite comfortable to have the resources in place to underpin that.

Francois Bouvignies

And maybe one word on LSA, which had a very strong year in '17 with [big] contracts. Do you see as well the contracts up for grab in '18 to offset this tough comps and how is it going in terms of competition here because it looks like you have very strong momentum in terms of market share, and the market as well is growing fast. How do you see any change in '18?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

So we've clearly won some landmark deals. We are with the biggest investors, the biggest Tier 1 operators and so we see that we can do more for them, we can add more functionality, we [can add] more test cases, we can deploy at greater scale and you can see the sort of paybacks that we've given our customers on that. So we would expect to do more with the customers that we've won. We also have quite a strong pipeline of new prospects and we won another significant new customer for VisionWorks in the first quarter already. There's more to come. Yes, our comps are a bit tough on the first half year. We had [a lot of] business that was coming through in the first quarter last year, particularly around Ethernet test actually. So that maybe a bit of a tough comp in the beginning, which is why we're just reemphasizing as you know, we have pretty much a second half year business in delivering the profitability and we don't see any change to that in 2018.

William Kirkness - *Jefferies LLC, Research Division - Equity Analyst*

Will Kirkness from Jefferies. I have 2 questions, please. And firstly it looks like the book-to-bill was strong in the fourth quarter, [115, 116]. So, I wondered if you could talk about how much of that was delivered in the fourth quarter and how much should flow through into the first quarter. And secondly, just to pick out on Networks & Security, at the Capital Markets Day, that same slide about the market had a growth CAGR, I think 10%. The slide now has a 4% to 6%. The time frame has slightly changed. I was wondering how much of that is capturing what we've already seen in regard to 400 gig and how much is maybe a little bit more caution just in outer years.

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Okay, (inaudible) the first question. Book-to-bill was stronger, I think we put about $20 million into the order book in the fourth quarter of 2017 compared to putting about $15 million into the order book in the fourth quarter of '16 and awful lot of that business was related to Lifecycle Service Assurance, so that will be delivered over the year, not in first quarter, a lot of the build in 2016 was more around Ethernet, so it benefited the first half. So hence a little bit of caution on seasonality. Yes, it was a good -- it was actually a good quarter, it was a great book-to-bill and we delivered same profitability in the fourth quarter as we did in the prior fourth quarter, but when I look at external competitor information, we put in a creditable performance in that quarter. The market growth rate that we're showing here is a tighter focus on the markets that we are currently serving. The piece that could drive this to a higher market growth opportunity and relates to areas where we see the potential, we're doing more development. So we would probably characterize that as around cloud testing, where we see upside opportunity against [these market growth rates, but given our current portfolio, these are] probably more -- reflects more our current market position.

THOMSON REUTERS

Unidentified Analyst

(inaudible) Can I ask a question on CyberFlood please. Is that a standalone business? Are you sort of selling that as an add-on to your other products. And you talked about you want to won business to establish strong position. Does that mean that you have a -- you think you have a small market position and that's something where you need to be much stronger?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

CyberFlood is a pure software virtual test tool. It can run on a dedicated appliance if the enterprise customer needs it or it can run within their end servers. It is based upon everything we've been doing with the firewall developers. So think of all the big security firewall companies, that's where we do the heavy lifting on testing the firewall. We've taken that capability and packaged it so that it can now be used by an enterprise customer. So think of a large financial institution, a large healthcare provider that can now run that solution across their networks and do a sort of testing to verify that their whole network performance has done security testing where they can identify things that other processes wouldn't capture and we've been demonstrating that. So, its looking to get into a new market for Spirent. So most of our equipment is being really tied to very capable, highly trained test engineers in development laboratories. This is now being packaged so that it can be run by the CSO, the Chief Security Officer's team within an enterprise. So we're developing new channels to market, new sales direction, new sales capability to go and demonstrate and win business with initial focus on financial institutions, London, New York, and also with healthcare providers because that's proved to be an area of quite significant vulnerability.

Unidentified Analyst

Tell us how big that business is right now?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

So the security business is about $30 million. The enterprise part of it is just a few million, but its a complete new opportunity for Spirent.

Unidentified Analyst

So is it marketed as CyberFlood?

Eric G. Hutchinson - *Spirent Communications plc - CEO and Executive Director*

Yes. Any more questions from anyone? Okay, well, thank you all for attending the presentation. Thank you for your questions and we look forward to talking to you again at the next results round with hopefully more good news. Thank you.