FTI CONSULTING GROUP LTD

Moderator: Eric Hutchison
August 5, 2015
10:30 GMT

Operator: This is conference #5251143

Ladies and gentlemen, thank you for standing by, and welcome to the Spirent Half Year Results call.

At this time, all participants are in a listen only mode. There'll be a presentation followed by a question and answer session, at which time, if you wish to ask a question, you could press star and 1 on your telephone keypad. I must advise you that this conference is being recorded today Wednesday the 5th of August, 2015.

I'd now like to hand the conference over to your speakers today, Eric Hutchinson, the Chief Executive Officer and Rachel Whiting, Finance Director. Please go ahead.

Eric Hutchinson: Thank you very much. Good morning, everyone. And thank you for joining this call at short notice. For those of you who don’t have a copy of the presentation, it's available on the investor section of the Spirent website. With will refer to the slide deck on this call.

Please note the Safe Harbor Statement at the front of the slide pack. As you've seen in the press release, we've released our figures earlier than planned, due to the re-forecasting of our full year expectations, which was completed this morning. Although we have seen good momentum in networks and applications segments, this has been offset by weakness in our wireless business and delays to the timing of revenues in service assurance.

This has an adverse impact on profitability in the first half. And although we expect the second half to show growth compared to last year, and revenues to be broadly in line with expectations for the full year, the low profit in the first half, the ongoing investment in the business and the anticipated revenue mix change means that profits for the year will be materially below the board's expectations.

I will provide some more detail on the outlook at the end of the presentation and some of the market dynamics, but first, Rachel is going to provide an overview of the results and the breakdown of the performance by division.

Rachel?

Rachel Whiting: Thank you, Eric. Good morning, everyone. I'd like to start by providing you with an overview of the first half. As Eric said, Networks and Applications gained momentum during the second quarter, but this was more than offset by softness in wireless. As previously highlighted in our trading update, a number of orders were received too late in the period to convert to revenue. As a result, this impacted our profit performance, which was also lower because of our increased investment in product development and in sales and marketing.

Our investment, which is now starting to show returns combined with the fact that we're maintaining our dividend at 1.68 cents per share, underlying our confidence in the future. We grew our order book, giving a book to bill ratio of 103, reflecting a strong finish to the half, which underpins this confidence.

Turning to the Group's comparative results for the first half, we see that revenue with 218.7 million with strong growth at 6 percent in North America, being offset by lower revenue in APAC and EMEA, which were down 10 percent and 9 percent respectively. As previously highlighted, compared to the first half of 2014, revenue was impacted by the timing of the shipment of handheld test tools. After a slow start to the year, revenue grew strongly in Q2, up 12 percent, but that was slightly below our expectations due to the many orders that were received too late in the period to convert to revenue.

As I've already mentioned, the reduced operating profit of 6 million reflects revenue being slightly below our expectations and the continuing investments that we're making in product development and in sales and marketing, particularly in our acquired businesses, which will benefit 2016 and beyond. The reported tax rate for the first half was 26 percent, and our expected rate for the full year is 25 percent.

Looking at each of the operating divisions, and first at Networks and Applications, which accounts for 49 percent of Group revenue, we saw growth in order intake across all businesses in this division, particularly in the second quarter, where we grew order intake by 6 percent, resulting in a book to bill ratio of 111. This growth was driven by high demand for our wireless infrastructure solutions where bookings were up 28 percent, driven by 4G network rollout. It was also driven by 100 gigabit Ethernet demand and by demand for our security solutions, where bookings were up 20 percent.

Gross margin, in this division, improved to 69.5 percent due to a positive product mix. We continued our investment here in product development and made additional investments in sales and marketing to work more directly with customers and to support the new product releases. During the period, we've also extended our leadership position and seen success at leading equipment vendors through our SDN and NFC test solutions where bookings were up 34 percent.

Turning now to the Wireless and Service Experience division which accounts for about 39 percent of Group revenue. In this division, we saw order intake and revenue both decrease by 2 percent. Growth in our positioning and service experience businesses was more than offset by softness in our wired business. On the plus side, we received significant orders from the US government sector (for) our high end solutions and positioning.

And in Service Experience, we benefited from test campaigns for new handsets and services and also from our new lab facility in China that we opened in the first half, which is already opening new opportunities for us in the region.

Wireless, on the other hand, was impacted by a combination of a major customer in Asia, spending significantly less in 2015 than in 2014 by consolidation in the wireless device ecosystems, and by intense competition in the market. As a result of the softness in wireless, we took action to reduce our costs in that business, which is – with expected annual cost savings of 6 million, and these will benefit the second half year. We finished the half year in a good position overall, with a book to billion ratio of 106.

Turning now to Service Assurance, which accounts for 12 percent of revenue in the first half, as we previously noted, revenue here was distorted by the phasing of the delivery of field test units to a major North American service provider. You see a large increase here in our cost as a result of the full impact of operating expenses from the acquisitions made in 2014, where we have been investing in new application development with a focus on (inaudible).

We've also developed our test center Live Virtual Probe, which is now in trials at two major US operators and a 100 gig Probe, which is already installed at one operator. And we've won new business for our software solutions in Mobilethink, which will be recognized as revenue in 2016 and beyond.

We're also currently bidding for business which we expect to benefit 2016. Now, let me hand you back to Eric, who will discuss the market, our strategy and the outlook.

Eric Hutchinson: Thank you, Rachel. We look at the market opportunities. You'll see that in the slide pack, there's a lot of information at the back of the presentation, which I've appended, which talks about the trends and the operational progress we are seeing in the various segments of the business. But for this – purposes of this call, let me summarize, we see significant investment worldwide in digital technologies, creating a backdrop that creates demand for new ways to test and assure digital connectivity.

The build out of new services by wireless service providers, as a result of the deployment of voice over LTE, voice over Wi-Fi, rich communication suite,

creates new requirements for test processes. Our customers are asking us to provide new test methodologies to meet the needs of virtual network management and seek to place more in the live network. Security threats and attacks are a daily occurrence, creating a need for better systems to test vulnerabilities, and we're investing in developing those capabilities.

A recurring theme is one of efficiency by better utilization of resources by our customers through more and more automation of test processes. And interoperability challenges are everywhere. We also see a need to test the vulnerability of positioning technologies and the associated timing processes with industrial and financial systems. We have introduced leading test solutions in all of these areas, generated by our reinvestment program, leaving us to have increased confidence in the future of our business.

The Networks and Applications segment, those businesses are seeing good growth, prospects in high speed Ethernet, 100 gigabit (annular) requirements for 25 gig bit developments and deployments. The Wireless Infrastructure market is growing strongly, driven by Wi-Fi and the deployment of Diameter technologies and advances have been made in our security test solutions.

Service Assurance is bidding for significant contracts of data analytics in customer experience management and prospects in high speed Ethernet probes and virtual technologies are promising for next year’s business. Wireless and Service Experience is seeing good levels of business in Service Experience and positioning, product lines, as Rachel mentioned, but the contraction in the carrier acceptance systems test market for smartphones, lower demand from major carriers and device manufacturers resulted in falling revenue for our wireless device business.

Our wireless new test platform is being developed. It has been launched and is expected to offset any further reductions in demand for existing device test systems in the future. Through the right strategic investments we have repositioned Spirent to be able to expand our served markets to $2.8 billion where we have significant market shares. The served markets all show growth potential with some niche segments growing at very high rates. We have added automotive, customer experience, (data) management, analytics

and device intelligence to the serve market and expanded our Wi-Fi test capabilities.

So, if I turn to the outlook, as Rachel says, the slow start to the year, combined with our strategy to invest in the health and long term prospects of the business, has resulted in low profitability for the first half. We continue to expect the second half to show growth over last year. And we expect full year revenues to be broadly in line with expectations.

Full year profit is likely to be materially below our previous expectations, reflecting the low profitability in the first half around (carrier) investment levels and the anticipated adverse revenue mix, where we're seeing a lower mix of pure software sales, due to timing issues. Our product offerings pipeline and customer activity levels give us confidence in (the) prospects for the Group, going forward.

So, thank you for attending the call. And may I pass back to the operator and Rachel and I will now take any questions you may have. Thank you.

Operator: Ladies and gentlemen, if you would like to ask a question, please press star 1 on your telephone keypad and wait for your name to be announced. That is star and 1 to ask a question.

Your first question comes from the line of Francois Meunier from Morgan Stanley. Please ask your question.

Francois Meunier: Morning, Eric and the team. So, just a few question about developments in H2, is there any – is there any pressure on gross margin in H2 to start with compared to last year? The OpEx, that’s my second question, in H1 were 143, shall we expect H2 OpEx to be flat or up compared to H1. And then maybe a longer term question, I understand that you're investing more because you're getting traction in new products, but that’s probably because the legacy is not doing so well, as you say, in the introduction, so how much time or how many years, hopefully not too many, will it take for operating margins to go back to 10 percent? Thank you.

Eric Hutchinson: Yes, did you say 10 percent, Francois?

Francois Meunier: Yes.

Eric Hutchinson: OK, so the prospects for the second half, in terms of the gross margin, we actually expect it to improve somewhat over the previous year. We are seeing the new products driving margins up. We are – continue to see a higher software content in the mix, compared to the second half of last year. So, we'll probably see about a 1 percentage point improvement in gross margin in the second half year.

In terms of the overhead spending, we're looking at around about $150 million, $154 million of overhead spending in the second half. That would get you to an operating profit, you know, not quite at the 10 percent level.

In terms of the investment, it was always looked as though it was going to take two years to get the business back on track. We were hoping – would like to have seen a bit more traction in the second quarter, in the third quarter, we are expecting to see growth, increase in profitability, and in the fourth quarter, on a full year basis for 2016, I think we are looking at being in a position to get through the 10 percent return on sales.

Thereafter, it rather depends on how much topline growth we can get in the business to see any further margin expansion above that.

Francois Meunier: All right. Thank you, Eric. That was very helpful.

Operator: Your next question comes from the line of Eoin Lambe from Liberum. Please ask your question.

Eoin Lambe: Hi there, good morning, a few if I could – firstly, just on your outlook, I'm trying to understand the divergence between your revenue outlook which is unchanged and your profit outlook which you reduced. Is there a mix shift in the second half of the year? Or why is revenue unchanged and profit a lot lower? Is there higher OpEx or lower gross margin? What's leading to the same revenue and lower profit?

Eric Hutchinson: If I – if I look at the way that the expectations for the business have panned out, we would have expiated to have made much more money in the second quarter and therefore in the first half year. Having dug that hole for ourselves, which really caused by two areas that – or three – three factors, one is that the actual revenue development didn't happen in the second quarter. We increased the order book rather than shipping it, so that's a bit of a timing effect. We should see that benefit coming back in, principally in the Networks and Applications segment in this – in Q3 and second half year.

The other two areas is one that – where we saw a decrease in the sale of our existing test systems in wireless device within Wireless and Service Experience. Those products carry a very high gross margin, so that's a negative effect on the mix. We were also spending around about $1 million a month on developing the new test platform, and we're not getting revenue for that in the first half. We've made some bookings at $1.6 million. We expect to increase that in the second half.

And the third area is that in our software based business with data analytics, we saw delays to projects being placed, which meant that we didn't see the revenue development there in the first half unless 100 – you know, nearly 100 percent gross margin, because it's software based. In the meantime, we have been developing a new product platform that will run on a lower cost database.

And so, we've stepped up our investment in development expenditure and in promoting that business quite considerably. The plan was to cover that increase in cost after the additional project revenue. That's been delayed through to the second half; I mean some of that into 2016. So, it's a combination of as we said product mix, which is really that impact. And if we take the miss on the first half and a slightly more – slightly more cautious view of second half profitability and then we get to the need to push the statement out earlier, and that's the conclusion that we came to earlier this morning.

Eoin Lambe: OK, thanks. And then just on trying to look at your margins versus your peer group, I think Ixia last night, in Q2, was at 19 percent margin and ISIS kind of

stable at 19 percent margin and JDSU low teens margin, I think in the first half you're at 3 percent margin. Is there any structure or reason why your margin should be lower than your peer group? And is that just due to your OpEx base – like I think your OpEx is roughly 60 percent of revenue, which is much higher than the rest of your peer group. Do you think your current cost base is suitable for your current revenue run rate? How do you get back to what the margin the other peers are doing?

Eric Hutchinson: Yes, so if you look at the businesses in the sector over historical periods, we all have to go through a period where we sort of reinvent our product lines, and you'll see lower profitability then followed by improvement and getting back on track, and it's all about getting the topline developing. We've clearly had to put much more effort into both catch up and then move ahead, in terms of product offering. We're demonstrating that, particularly in the Networks and Applications business. We're still going through that phase in the Wireless business, where we're reinventing or evolving our product offering. And we are developing a whole new data analytics strategy and platform in Service Assurance.

So, you're right, the operating cost is far too high, compared to our current revenues. We've taken some actions where it's very specific, where we feel that it's wrong to go on spending that money, I think as a company, as a board and our strategy, that where we are investing, we are seeing businesses that are gaining a lot of recognition and credibility in the market, and that we would see our upline growth coming through and therefore, repairing our operating return on sales. And the aspiration is to get it back up into the high teens.

Eoin Lambe: OK. Thanks. And then just one final one on consolidation again, I see the key site is acquiring Anite. I was wondering what your latest thoughts on consolidation in this space are. I think JDSU is spinning out its testing business. And the sector would benefit from further consolidation. How do you see Spirent taking part – or do you think the sector will consolidate further? And how do you see Spirent taking part in that consolidation?

Eric Hutchison: Yes, so logically – well, first the backdrop is we're seeing more pure play test and measurement businesses in data communications in the public markets than we have seen for many, many years. And people are, you know, splitting away as you say, JDSU is splitting into VRV and away from optical. You've seen the Dynamic business pushed out into (Net Scale). You've now seen Key Site as being, you know, test and measurement and divorced from life sciences and so on, so there's a lot of pure play out there.

We've started to see some of those management teams utilizing their capital base such as, you know, acquisition of Anite. I think we will continue to see activity in the sector. I would very much like to be in a position to participate but my key focus is repairing the EBIT and greater prospects for Spirent, which would then – you know, give us the capacity to go and do something.

In the meantime, what will happen will happen. And I would expect to see more activity over the next 6 to 12 months.

Eoin Lambe: OK. Thank you very much.

Operator: Your next question comes from Arun George from Canaccord. Please go ahead.

Arun Canaccord: Morning, Eric and Rachel, one question, it's on your revenue outlook for the year, I mean clearly you've said you're going to be broadly inline with consensus …

Eric Hutchinson: Yes.

Arun Canaccord: … you know, that assumes almost, you know, more than a double digit of serious growth in the second half. So, I was just trying to understand in terms of your various business lines, if you can give a bit more color on – you know, your confidence on – you know, growing this pre-business launch fairly aggressively in the second half …

Eric Hutchinson: (Sure).

Arun Canaccord: … in the current backdrop, yes.

Eric Hutchison: Yes, OK. So, by taking that, the Networks and Applications business, I think, as Rachel mentioned, we grew the order book in the second quarter. I'm getting a bit of interference on the line …

Operator: Is this better now?

Eric Hutchison: Yes. So, we built the order book there, which gives us confidence that we should see good revenue development in Networks Applications in the third quarter, and actually we would normally expect to see growth in the fourth quarter as well. So, there's a good $5 million to $6 million going into Q3 that is building order book.

In the Service Assurance segment, you know, we have built order book back end of last year, that will unwind in the second half of 2015. And there’s certainly at least $10 million there that wasn’t – is over and above the run rate in H2 of ’14. The Wireless Service Experience business, we saw growth in order book in service experience and positioning. And we're sort of holding our own in terms of bookings on the wireless business unit. So, that we'd probably – we would be more likely to say would be flat lining revenues H2 over H2 ‘14, so we'd expect to see revenue growth in Network Applications, revenue growth in Service Assurance, a fair amount of that is in order book.

Arun Canaccord: OK, and just a follow up question on there's one major customer in Asia, do you – do you – I guess can you give us some insight on whether this was also due to maybe some competitive pressure in that customer or is it – was it simply a case of that customer deciding to do less? And the follow on to that is when do you expect this customer to resume its normal level or …

(Crosstalk)

Eric Hutchison: So I mean the customer in question spent a huge amount of money with us in 2014. And he's not repeating at those levels, and is well below those levels in 2015. I would think given the dynamics in the small frame market, that it's unlikely that we'll see that come back strongly in the near term. I'm not sure how it will play out over the longer term. We are seeing some others buying test systems in the wireless market, who are new customers, which are based

in Asia. So, we are seeing some diversification, it's just not to the same level of this – of a major device manufacturer out there. Apologies, I can't mention names.

Arun Canaccord: All right. Great, thanks. Thank you.

Operator: Your next question comes from James Goodman from Barclays. Please go ahead.

James Goodman: Thank you. Good morning. So, could I just firstly come back to a clarification on I think the first question around the OpEx and the profitability. I think you said that you were going to be just short of 10 percent margin for the full year, but if I take a little bit off the sort of consensus revenue number, which I think is 483 or so at the moment, apply 71 percent gross margin in the second half and take out, I think you said $154 million of OpEx, I get closer to 7 percent. Is that – is that – is that right? Or have I missed something there? And then I've got a couple of follow ups on the – on the investment.

Rachel Whiting: So, gross margin was improving about 1 percent over the last year …

Eric Hutchinson: On a full year basis.

Rachel Whiting: … on a full year basis, and we've already given the number for the OpEx for the H2, expecting it to be around $154, so that would get you down to a return on sales for the full year of near sort of 8 percent …

Eric Hutchinson: Sorry, maybe I confused the point by mixing H2 and full year; H2, we expect (inaudible) to be above 10 percent.

James Goodman: Right. OK, that’s a helpful clarification. Thank you. So, 7 to 8 percent full year then would be (essential)?

Eric Hutchinson: Yes, apologies if I misled you.

James Goodman: OK. No, that’s fine, thank you. And then on the – on the investment, so it looks like – just simplistically looking at the P&L and the divisionals that the investment is skewed primarily to sales and marketing rather than R&D, and

so I wanted to ask, you know, why so much to the sales resource? And is that really to maintain the current revenue profile?

And secondly, it looks also like it's skewed to Service Assurance, whereas I thought it might be more focused on the core performance analysis divisions. So, if you could just help me understand that (SKU) of investment.

Eric Hutchinson: Yes, I think the back – the backdrop is that we'd stepped up our pro-development engineering spend quite significantly and we feel that we've got those resources in the right place. The area that we fell that we've been at a competitive disadvantage is both marketing the company and in getting people – you know, with the customer, hence the step up in sales and marketing efforts this year, compared to the prior year.

A little bit of that is distorted by the fact that we acquired four businesses last year that all carry sales and marketing overhead. So, it looks like – it exaggerates the position a bit, but it really is that – you know, we feel that we've done developments but we've got the products and we really need to go out and market and sell hard to gain share.

The reason that Service Assurance is impacted more is I think Rachel, really the acquisition …

Rachel Whiting: It (has) very much to do with the acquisitions, but we have also, as we've said we've development the new test center Live Virtual Probe and 100 gig Probe in the course of this assurance business as well.

Eric Hutchinson: And we've gotten substantial spending on developing new data analytics platform.

James Goodman: OK. Thank you.

Operator: Your next question comes from Lee Simpson from Stifel. Please go ahead.

Lee Simpson: Great. Thanks so much. That's Stifel. Just a couple of questions that occurred on virtualization. So, maybe if I could just quickly ask on the threats or opportunities around open source. As we look at it, you know – you know,

you can see from your marketing spend profile that you're traveling the world a little more and what it is you're trying to do, you'll be talking to Chinese internet companies et cetera …

Eric Hutchinson: Right.

Lee Simpson: … I just wanted to see what their sort of appetite was for – when they look at virtualized network functions, whether they're doing that with legacy OpenStack Daylight and/or whether or not that's been a big hand hold with you guys.

And maybe related to that, just wanted to try and understand the deployment whether it's reached the enterprise data center space as yet, again virtualization and again referencing the marketing spend, you know, it seemed to us there was a lot of reticence for companies to decouple firewalls, for instance, and to really spend on test. This is a real culture shift for enterprise, and if you just give us a sense for, you know, how that testing as a service is working …

Eric Hutchinson: Yes.

Lee Simpson: … in that vertical.

Eric Hutchinson: Yes, I mean you'll – you're absolutely right. The data center operators, anybody offering services over the – over the net, they think open source, OpenStack, their ability and their deployments around that, what we're offering them, from a test and assurance perspective is as you implement these processes, how do validate and assure that everything is working well with this space on open platform, or whether it's more proprietary.

Now, our business is primarily focused around the service provider. We are not a bit supplier of test and assurance into enterprise, so we are gaining more traction with the internet service providers, software as a service providers, but we – we've yet to break into any significant enterprise deployment, so I'm not sure I'm qualified to give you much more color on the enterprise side of the house, Lee, I'm afraid.

Lee Simpson: But I mean just …

Eric Hutchison: But you are right that there is – there is a reticence about opening up by enterprise customers. They're very concerned about control over their systems and security.

Lee Simpson: Yes.

Eric Hutchison: And that will – that will be an important theme for us going forward.

Lee Simpson: Precisely. And with that, I mean because it seems to me at least that – I mean I'm just trying to determine – it looks as through there's two distinct phases in virtualization spend, and that second one and longer one, that's more drawn out, could be that enterprise space, but potentially, larger. And it's just really trying to get a sense for – you know, how far down the road they are, at least in – in you know, thinking about their test (uptakes).

Eric Hutchison: As I say, from our perspective, it's relatively early phase but we do see that it will offer growth for us, you know, 2017 beyond probably.

Lee Simpson: But does that suggest that OpEx is going to be – have to be still relatively (flat) in 2016?

Eric Hutchison: I think it limits my scope to reduce it, yes.

Lee Simpson: Yes, OK. Perfectly clear. Thanks, Eric.

Eric Hutchison: Thank you.

Operator: Your next question comes from Nick James from Numis. Please go ahead.

Nick James: Morning. Yes, just a couple of questions, one was in terms of the revised profit guidance, I guess – I understand kind of the mix effects on gross margin, but a big part seems to be that the OpEx is running well ahead of what was in consensus and what seems to be your greatest expectations, so I'm just trying to understand how that can come about really, the OpEx is running well ahead of expectations.

And then the second one's just on the wireless device test business is that part of Wireless and Service Experience loss making at this point? Or is it still profitable? And would there be scope for taking this in, a more drastic action to that part of the business which seems to be causing some issues?

Eric Hutchinson: I mean I think the short answer is our original anticipation was that we would outperform on the revenue line. The spending profile is in line with our plan …

Rachel Whiting: It's behind our plan …

Eric Hutchinson: … slightly lower …

Rachel Whiting: Yes.

Eric Hutchinson: … but we haven't – we haven't seen the big software contracts that we were anticipating would help fund that, and therefore, we'd hit the EBIT number.

The question about wireless …

Rachel Whiting: The cost cutting …

Eric Hutchinson: Well, the challenge there is we've taken action to – so that we can focus on the future developments. I think there is a risk to that business if we take it deeper now. So, I think there is limited scope about doing more within the wireless business. I think you'd have to take a different strategic view if you were going to do anything – anymore than that, Nick.

Nick James: But just that kind of wireless device business in isolation, I mean is it – is it making any contribution or is it making a loss …

Eric Hutchinson: It made a loss in the first half …

Rachel Whiting: Yes, and for the full year, it will make a loss, so second half, it …

(Crosstalk)

Rachel Whiting: … it will – it will make a small profit, but you know, we've attempted to right size it without damaging it so that it does return to profitability, going forward.

Nick James: OK. That’s great. Thanks very much.

Operator: Your next question comes from Gareth Jenkins from UBS. Please go ahead.

Gareth Jenkins: ... if I could. It looks like the absolutely shortfall for the full year, EBIT is around $13 to $14 million just using your numbers you've given us. Can you just – as a follow up to some of the earlier questions, can you just give us a sense of how that shortfall is mixing between wireless device shortfall, you know, slippage and software contracts, investments. That’s the first question. So, I'll take the second one afterwards, if that’s OK.

Eric Hutchinson: Well, if I – if I look at that, what we'll be seeing – and so we're seeing a decrease in the Wireless Service Experience EBIT number, which is around about two thirds of the number that you referred to. And the other third is really coming out of the Service Assurance segment. And it's primarily based around the investments were making in the building out the new data analytics platform and the timing of that – of those software contracts.

The positive is that we see good momentum in the Networks and Applications business, and we should see meaningful profit growth and an increase in the operating returns sales in that business.

Gareth Jenkins: Just as a follow on then, I've got a couple more if that’s all right. The long term prospects for the wireless device testing, given it's structurally more competitive than some of the other areas that you're in, how do you see the – you know, what's the long term game plan? Is it to – you know, effectively have a smaller higher margin business that’s more software orientated in the future? Is it just – you know, you expect more consolidation in that area, so maybe this is to end up with fewer players?

And then just secondly, in the past, you've talked about getting back to high double digit – sorry, no high double digit – high teens margins, as a Group, I just wondered – you know, do you still, as a business that you're doing more

now than you've done in the past so that structurally those margins maybe are a bit lower, going forward. Or do you feel that, given the profile of your business you know, you can – you can still get to that level?

Eric Hutchinson: OK, the wireless business really will be focused around having a software based (inaudible) platform. So, in revenue terms, undoubtedly, it will be a smaller business than it was before, but with higher gross margins. And then it really taps into – you know, how can we exploit that software test platform to leading to the longer term areas that look promising, such as automotive, so connected vehicles and machine to machine connectivity?

That business benefits a lot from the capabilities in Networks and Applications and it's looking to get more links into live network deployments. So, it's really a – the first option you gave me, software based, a bit smaller, but increased margin.

As a business, we – were certainly doing more. We're going after more opportunities. And in terms of the profile of the business, we're investing more in earlier phase development that takes some time to pay off. And it takes a good 12 months to get paid product to market. And it takes about 12 months from that to get to a meaningful revenue. So, it's about a 24 month process.

I've kicked off probably more initiatives across the Group than I – than we have done for many, many years. So yes, now as that moves through and the business moves more to software based tools, provision of testing as a service, we are developing subscription license models in parts of the business. As that evolves, then hopefully in a few years time, we will see a better margin profile and hopefully a bit more predictability around the revenue outlook.

Operator: Your next question comes from Rahul Chopra from Citigroup. Please go ahead.

Rahul Chopra: Yes, good morning. Earlier in the call, you said that you pre-announced results because of change in forecast for full year, and obviously you had (partly) inline trading Q2 update last month. So, my question is that what really has changed for this intermediate period that you are significantly

having to step up in this investment program, firstly? And secondly, can you give us a bit more color, in terms of the OpEx for next year as well, please? Thank you.

Eric Hutchison: OK, so we went to our normal – our normal reassessment of the businesses product by product. It's a process we've followed our normal timetable. The conclusion we came to was that really, the mix of revenues and the timing of the software contracts and also a more pessimistic view about the development of wireless device test revenue resulted in a reduced EBIT outlook.

It wasn't that in the last three weeks that we decided to spend more money investing in the business. We're just not getting the gross contribution that was covering the spending plan that we already had. We came to the conclusion that it's the right thing for the health of the business to continue to invest in the future for Spirent. And as I say – as I said earlier, we got to that conclusion earlier this morning, and hence we put the statement out.

Our trading update earlier in the quarter was all about order intake and revenue numbers that we had at the time. We hadn't – we weren't in the position to do any deep dives on the profitability at that stage.

Rahul Chopra: But just to be clear, the investments in the R&D and product are still relating to the OpEx part of it, right? So, just wanted to check in terms of how – what has changed in terms of – I mean how – the step up in investment, I mean …

Eric Hutchinson: So, the step up in investment, we flagged at the beginning of the year. We're spending in line with those plans. The difference, from our perspective, is that we have – we were expecting to see a higher profitability at the gross profit level as we had planned to have much higher software contract mix in our revenue. We don't see that happening this year.

Rahul Chopra: OK. And what about next year, in terms of any color for OpEx or probably gross margin mix (OpEx) for the next year?

Eric Hutchinson: We would – at this stage, we haven't done our detailed planning for next year. I would hope that we would see a robust growth profit margin development,

and we would seek to contain our overhead spending and not increase it significantly.

Rahul Chopra: OK. Thank you very much.

Operator: There are no further questions at this time.

Eric Hutchinson: OK. Thank you very much. If there are no further questions, I'll draw the call to a close. Have we got another question?

Operator: Yes, we …

Eric Hutchinson: So one more question.

Operator: We have had a question come from the line of (Edward Donohue) from ONE Investments. Please go ahead.

(Edward Donohue): Hi. A quick question, a bit simplistic, just with regard to the actual sort of guidance you're giving, this is – am I correct in this, this is purely a phasing issue, rather than you've actually missing the business itself. So, we're not going to have to see a step up in sales and marketing to actually go out there and capture the business, is it actually basically orders have arrived, it's a – it's a phasing of when they basically just dropped into the sort of – the timing …

Eric Hutchinson: Yes …

(Edward Donohue): … of the – of the quarter. It's not that you've actually missed business, and therefore we're going to require greater spend to basically go out there and capture that business?

Eric Hutchinson: No, that’s absolutely correct. We've seen some push out on some of our major contracts. And we've already stepped up our sales and marketing effort. I don’t see that we should be …

(Crosstalk)

Eric Hutchinson: … need to step up from here, it's just unfortunate that accounting periods have got deadlines on them.

(Edward Donohue): OK, that's what – that's what I was thinking, and just …

Eric Hutchinson: Yes.

(Edward Donohue): … on – and if you actually looked at what your team is actually winning, is it what you would have expected them to actually be winning, and looking at the pipeline going forward as well, do you see yourselves in that competitive disadvantage on that front either?

Eric Hutchinson: On the majority of the businesses, they are in good health and we're winning what we expect. And we've got good prospects.

(Edward Donohue): Right, and …

Eric Hutchinson: But we're just repeating …

(Edward Donohue): … just on the – on the other one on – I'm sorry, just on – and then the other one being on the – you allude to the software projects, are those actually in your books and they will be actually phasing through H2? Or your view yet to still close those?

Eric Hutchinson: Where those – so they're not all in our books. We've got some in our books. But the way that it works with the customer is that we have detailed discussions with them on their requirements. They are budgeting to spend that money with us. And we need to work out the detail of the statement of works for each of those projects. And then we can book an order.

(Edward Donohue): All right. The obvious next question is is those budgets that they're allocating, are they the same size as you were anticipating when you did the original projections then?

Eric Hutchinson: Yes, they are.

(Edward Donohue): OK. Cool. Thank you very much.

Operator: Your next question comes from Robert Lamb from Jefferies. Please go ahead.

Robert Lamb: Thank you. Just one quick one and then maybe a longer one on the wireless business. I just wanted to clarify the $150, $154 on the OpEx, is that an underlying number or an IFRS number?

Rachel Whiting: That's the OpEx number …

Eric Hutchinson: It was our adjusted OpEx number …

Rachel Whiting: Yes.

Robert Lamb: So that excludes …

Rachel Whiting: That doesn't include intangible, amortization or anything like that.

Robert Lamb: OK. Great. And then just in terms of wireless business, I mean it sounds like you're taking some corrective action there. You've got a new product in the pipeline …

Eric Hutchinson: Yes.

Robert Lamb: … but end markets, do you feel quite soft there, at least in the short term, and maybe even, you know, longer term growth is slowing in smartphones, so how should we thinking about the shape of our business longer term?

Eric Hutchinson: So, I think it's going to go through a period of flatlining, in rev terms, for the next couple of years probably. But as I said earlier, we will seek to have a higher software content and therefore, a better gross margin and get the business back into probably modest profitability. So, at least it won't be a drag on the Group.

Robert Lamb: OK. Thanks a lot.

Operator: There are no further questions.

Eric Hutchinson: OK. Thank you very much, everyone for attending and for your questions, which were interesting and (insightive). Thank you very much. And I look forward to catching up with you over the next few days. Thank you.

Rachel Whiting: Thank you.

Operator: Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.

END