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PRESENTATION

Operator

Good day, and welcome to the Spirent half-year results 2011 conference call. At this time I'd like to transfer the conference over to Bill Burns, CEO, and Eric Hutchinson, CFO. Please go ahead, sir.

Bill Burns - *Spirent Communications plc - CEO*

Morning, everyone. Welcome to Spirent's 2011 first half earnings announcement. I'm Bill Burns, Chief Executive Officer, and with me today is Eric Hutchinson, our Chief Financial Officer.

Before we get started, I'd like to bring your attention to the Safe Harbor Statement. If you can read through it for a moment that would be much appreciated.

Investment trends remain positive across the communications industry, driven by the demand for data connectivity worldwide. We really see that the consumer and business demand for anytime, anywhere, always on data connectivity continues to drive the telecom and IT environment.

And that's a trend we expect to continue over the next multiple years as we're seeing the increased demand driven by applications; those of consumer business customers using applications across their home broadband, their business environment and a mobile device, no matter where they are in the world.

And this demand for applications and data connectivity and Internet access, the move from PCs to tablets, all an environment to move from hosted environments to Cloud computing, all that's driving the demand across the telecom and IT sectors, and that continues.

Spirent's growth through the first half is really driven by our broad solutions portfolio and our diversified customer base.

So we develop solutions that are tested all the way from the applications to the performance of the network, from wireline to wireless, all the way through the Cloud computing and the hosted environments to test how the applications play in that environment inside virtualization. And we sell across a diverse customer base around the globe, both wireline and wireless, inside the network equipment vendors that are mobile device suppliers and to the service providers, no matter where you are in the world.

And diversification of our portfolio and the convergence of networks together gives Spirent a strength in the industry. So today our customers are asking ever more for test solutions that span both wireline and wireless, that span applications' performance and security all together.

And those customers are increasing the breadth of their portfolios. Typical wireline customers, or wireline customers in the past, that developed wireless switches and routers are now adding mobility context to that. So they're changing those switching and routing devices to actually handle mobile traffic.

We're seeing Smartphone devices continue to add higher data rates, applications such as global positioning and others to those devices. So the devices are crossing over between technologies and the breadth and depth of our portfolio is helping with Spirent's growth.

We saw strong growth in the first half across our wireless and positioning businesses. So our 3G wireless business, our LTE business, our Fader's product and mobile backhaul, mobile packet core and global positioning all experienced strong growth in the first half of the year.

We saw a more cautious stance adopted by some of our wireline customers, specifically in the US, as we reached the second half of second quarter, so towards the very end of the period, and I think that was seen primarily by moderating growth rates.

So we saw a lot of recovery in the market in 2010 and into the first part of 2011, and we've seen those growth rates moderate a bit. And I think because those growth rates are now moderating, moderating into, quite honestly, levels that we had expected them to moderate to, we're seeing a bit of caution in the market.

So it's a bit normal. As you see growth rates come down, you're still seeing growth across the entire telecom and IT sector today, you're seeing some companies do better than others, but that's a normal dynamic within the industry. And most customers that aren't doing very well, quite honestly, spend more on test equipment as they try to regain their market share and their performance in the industry.

Our pace of innovation continues as we invest in new products, evolving our current solutions, adding new technologies to the current products we sell into the market, but also expanding our served markets. So we're looking to grow into new adjacent markets organically to grow our markets overall and secure our top line growth as a business.

The increased adoption in the areas of data center, mobile backhaul, global positioning, LTE, our entire portfolio of products today is experiencing growth. We're seeing growth across all of our businesses today, whether it's our Networks Applications group or Wireless group, Global Positioning, Service Assurance and our Systems group have all experienced growth for the first half year.

So very solid set of financial results in the first half year. Our book-to-bill ratio is 99 for the Group, Eric will cover the more detailed financials. We'll see a stronger order book. As you look at Performance Analysis, revenue up 15% to $260 million, operating profit up 16% to $57.8 million, return on sales remained at 22% for the period, free cash flow at $17.1 million -- it was as we reinvested in the business for growth -- and adjusted EPS up 24%.

I'll spend a bit of time talking about more of the industry and the dynamics across the industry after Eric covers the financials in detail. So, at this point, I'll hand over to Eric to cover first half financials in detail.

Eric Hutchinson - *Spirent Communications plc - CFO*

Thank you very much, Bill. So if I turn to the full year -- sorry, the half-year consolidated results for the total Group, you can see, as Bill said, there's strong top line growth, ahead of expectations. As we go through the divisions, you'll see it was stronger still in Performance Analysis.

Gross margin maintained at 65.5%, and again we'll go through the divisions, but you'll see an increasing gross margin in the Performance Analysis business, and the Service Assurance business down, as we were expecting. And you can see the investment in product development and sales and distribution; so a $5.8 million increase in engineering spend and sales and marketing costs also expanding the resource levels there.

Aim to be to grow the top line, grow the profits pretty much in line with that, so slightly outperformance here.

Share-based payment and intangible amortization is up, as a result of the acquisition of the Fanfare business. You can see that they've got amortization on Fanfare running just under $2 million a year or so, the detail's in the statement, and the acquisition expenses on Fanfare of $1.2 million.

Financial income is a net positive of $0.6 million, against where we've been running at a negative. We're seeing improved financial returns within the pension fund, which is on balance sheet, so that's really where that turnaround's comes from. So good profit performance.

Tax expense, we're down to 29.4% in the first half. That's the benefit of being able to recognize and utilize some losses that we didn't think we'd have access to as early. So we've got a bit of benefit this year from that. And also there's some volatility in the tax charge as you run through tax deductions for employees exercising share options, so that pulled the rate down a bit. Forecasting a 30% rate for the full year in 2011 and we're sticking to a 31.5% rate for taxes in 2012 and onwards.

So basic EPS up 17% and, on our adjusted basis, up 24%.

Turning to Performance Analysis, you see here that the revenue growth was 17%, that's certainly a strong performance; order book grew by $7.8 million in the half year; and you can see the gross margin increase to 71.5%, so just about where we were expecting it to be. That's the benefit of mix of sales. Actually there was more third party flow through of revenue in the first half of '10, so there's a slightly lower proportion of that in 2011.

Here there was the bulk of the investment in product developments going on as we're looking to drive more organic growth and give surety to future growth rates in the business, primarily focused on developing new wireless device test capability, but also expanding our capabilities in 10 gigabit, 40 gigabit, 100 gigabit Ethernet test processes, and this has got the selling cost.

So operating profit actually grew 22% on 17%. We did expand the return on sales by 1 percentage point, from 1.1% to 25.5 percentage points. So nice strong performance.

If you look at the half-year record, first half year, it's one of those very nice charts as a CFO you like to put up; so it's all going up from the left to the right. 14% growth in order intake, so $207 million of order intake in the half year. That's a book-to-bill ratio of 104 for the Performance Analysis business. Quarter two it was 109, so we had about $116 million of bookings in the second quarter.

That accelerated growth rate really came from our wireless and positioning products. We're seeing a more muted rate of growth in the Ethernet networks and applications wireline market, which is, again, something we've been guiding to for some time. So low single-digit rates of growth in that part of the business.

Operating profit, as we saw, bumped up by $9.2 million, and the trajectory on profit growth and expanding return on sales continues to be a feature of the business. So entering the second half with a nice solid order book position on our core business.

Service Assurance, we were expecting more modest rates of sales growth. 12%, again, I think, pretty much in line, slightly better than some expectations. We were guiding gross margins down here. We had a very high proportion of the software content with some one-off contracts in the first half of 2010 so we had a bit more just hardware flow through of product here, so that pulled us down to 55.5%.

You can see we've been controlling the overhead costs in this business, so able to maintain return on sales at 17.1%, which is entirely within the normal range for the business. So this is all about driving forward on our Ethernet monitoring product, Spirent TestCenter Live, and looking to win some contracts in the handheld test business area.

Pretty solid performance. I know the profit's down, but it's down into the expected range for Service Assurance, and in line with our plan.

Systems, 5% revenue growth; exactly in line with the expected growth rate for the business. If you recall, there were some concerns. We saw some slow down in the Medicare market in the first quarter, which slowed up orders, order intake, in that first quarter. That rebounded and came back in the second quarter. So we're back on track.

Gross margins expanding, partly because we've got a slightly more favorable product mix, but we're also off shoring more manufacturing to Southern China. So that should be a continuing feature of the business to grow the gross margin on this area.

We are increasing some engineering here to expand the surf market and the number of products there, which is continuing to make this business more resilient, and therefore more attractive.

The only downside is that overheads in this business are primarily denominated in sterling, so when we translate it into dollars, you've got a drag on the profit number of $0.7 million in this period compared to the first half of 2010.

Again, return on sales at 15% is within the normal range for our business, and continues to be best in class in this industry sector.

Free cash flow -- depreciation, profit performance, intangibles, just as you can see here. Big investment in the business in working capital terms. There's two primary areas there.

We saw a big increase in receivables in the period. We saw a lot of activity towards the end of the second quarter -- that was a combination of very strong growth rates in wireless and positioning being skewed towards the end of the second quarter. But also delays in placing orders on our Networks and Applications business meant that activity was pushed to the end. So we couldn't collect the cash in the period on those. Day sales outstanding are 59 days, with 59 days sales outstanding at the end of December.

The other factor is that we needed to increase our inventories, because we're shipping all of our buffer stock, so we wanted to ensure that we could maintain customer service levels. And, again, if you look in the notes, you'll see that payables actually decreased by $6.8 million in the period as we paid for some of that inventory increase that we saw at the end of last year and that cash flow this time round. Expecting to see some of that being clawed back in the second half, and that cash generation for Q3, Q4 should be back to our normal high levels.

Again the tax shelter is coming off, so increase in tax payments as we guided to. One of the benefits of success with more profits is you pay more tax.

Net capital expenditure, investment intangible assets is running at $8.7 million, about that, and that's primarily equipment for our engineers to develop product, and also having demonstration equipment out in the field for our sales engineers to go and demonstrate to customers, and win more business.

Also in here is the purchase of $3.7 million worth of intangibles. This gives us manufacturing rights for parts of the requirement for our LTE test system. And the objective of doing that was actually to improve the gross margins in that product area going forward.

So that's somewhat higher than people were expecting to see on CapEx. Second half will run at, more likely, underlying $8 million to $9 million.

So $17 million down against last year; certainly below plan, mainly because of this investment in working capital and pensions.

Closing cash is $210.1 million. That's after the acquisition of Fanfare of $15 million and some share buybacks that we did in the first quarter of $10 million.

We continue to focus on finding attractive investments for expansion through acquisition for the cash balances, and we continue to have conversations with people and search for attractive places to invest the money.

Dividend -- as we said, the EPS grew 17% at the basic level, 24% to $0.0625 at the adjusted level. Just to remind you, our policy is to maintain a high dividend cover and have a sustainably progressive dividend policy. So we're giving an interim dividend up 15% to $0.0126 per share. That will be paid in sterling, 0.77p. So that's a 12% increase in sterling terms at the exchange rate of $1.64 to GBP1, about $8.4 million of cash distribution. And the cover at the interim stage is 5 times.

So, with that, I'll hand back to Bill to talk about strategy, markets and outlook.

Bill Burns - *Spirent Communications plc - CEO*

Thank you, Eric. I'd better spend a couple of minutes talking about the dynamics we're seeing across the .com and IT sector, our strategy to address those opportunities. We'll talk a little bit about how the network is converging, and how it plays to Spirent's strength across the broad solutions portfolio and customer base. Then we'll talk a little bit about some of the wins we had in the first half and some of the recognitions and awards we received in the first half year. And wrap up by talking about some of the technologies that are just at their infancy, and why we have confidence that the growth across telecom and IT is here to stay for some time and talk about that, and then we'll wrap up with an outlook.

This is a busy chart, but if you start at the top, what you see is this anytime, anywhere demand for data connectivity we talked about at the beginning of the presentation, really driven by consumers, with social networking, and video, and use of applications every day, to business customers and their continued demand for data, no matter where they are in the world, is really driving a growing demand for bandwidth and connectivity, and, quite honestly, unpredictable connectivity sometimes, as we've seen a few outages in the Cloud computing environment in the first half year.

We're seeing stress on the network from a connectivity perspective, and also this unpredictable rates of data usage across the network. And that's putting pressure on the network operations centers and the management teams of service providers and alternative service providers, Cloud computing providers, to look for new ways and new [innov] ways to drive revenue and lower cost.

So what they're seeing today is this cost of running a network isn't really truly being funded by the revenue growth they're seeing today. And the network equipment vendors and mobile device suppliers are looking for new innovative solutions to help the service providers in Cloud computing environments to lower their cost and, more importantly, increase their revenue.

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So what we're seeing is technologies like virtualization driving down the cost of servers inside a computer environment. You're seeing faster speeds of Ethernet, where you need less interfaces to carry more traffic. You're seeing the evolution of a Packet Core, which is combining wireline and wireless traffic on the same network, and the convergence of that. We're seeing LTE generating faster data rates and more efficiency across the wireless network in the same amount of bandwidth.

All these things are focused on lowering cost and creating new revenue opportunities. So the service providers today want to be Cloud computing providers; they want to play a role in the hosting environment. So we're seeing operators like NTT and Verizon, and others, want to be in a hosted environment, step in and be Cloud computing service providers to partake in the revenues associated with not just the bandwidth across the network, but the advertising and the hosting revenues associated with the dynamics inside telecom and IT.

So this innovation is driving need for test. As they develop these new technologies and are rolled out on the network, the network equipment vendors, mobile device suppliers, all need to test this equipment before they bring it to market. And the service providers and Cloud computing providers are testing in their environments to make sure the equipment and the services they want to bring online are actually going to do what they expect. And they're testing around performance and scalability and security, inside the network.

All of this with the focus on improving quality of experience to the end-user so they can attract new customers, or retain their current customers, or generate more revenue overall and increase the quality of experience to the end-user.

So this dynamic across the telecom industry, driven and underpinned by applications, driving demand on service providers, creating opportunities for equipment manufacturers and mobile device suppliers to create enhanced areas of convergence and new building of data centers inside the service providers and Cloud computing environments, to serve the demand by these end-customers, is a dynamic we expect, and a trend we expect, to continue over the next several years.

If you look at Spirent's strategy to address that area, it's really about continuing to focus on these growing and emerging markets. So we've talked about 4G LTE, higher speed Ethernet, global positioning as it becomes part of everyday life, as we continue to see the convergence of wireline and wireless. So our wireline test solutions are now adding mobility solutions to those. We continue to enhance our solutions portfolio to meet the demands of the growing and emerging technology trends in the industry.

We're also looking at areas to expand our served markets, so to spend some of our R&D dollars to move into new markets adjacent to the current markets we're in today.

It's about investing in our people, because Spirent today is really about it's people that drive the innovation across everything we do. We've got to be on the forefront of the market, developing the innovative solutions to the market, at the right time, when our customers want them. And our engineering teams, our sales and marketing teams that stay close to the customer and all the people who support that as Spirent is really what Spirent's about.

We continue to focus on evolving our current solutions portfolio and expanding in the new markets. So we've talked a lot about this in the past. People don't just buy a test solution for what it does today; they buy it to use for many years. So they buy a CDMA test solution, they expect us to evolve it to LTE. They buy a UMTS test solution in 3G, they expect the evolution to LTE, along with that test solution.

When they buy a 1 gigabit or 10 gigabit test solution from us on the wireline side, they expect us to evolve that, to add application support and testing on it. They expect us to be able to service the mobile market, as they're converging today. They expect us to add 40 gigabit and 100 gigabit test solutions to that. So this evolution of our test portfolio is important to our customers and a strategy for us to continue to maintain.

And last, but not least, and, importantly, is our global reach. So the fact that we service customers across the globe, the strength we have in the Asian market, in Europe and in North America, the fact that we stay close to our customers. When customers are struggling in the marketplace, what we quite honestly see is, they pull back for a short amount of time, and then they reinvest in their R&D areas that represent their future. So they spend more on test equipment with us to regain their dominance in the marketplace. So what we're seeing is this global reach and the relationships we have with customers is truly a strength of Spirent's.

We'll look at the converged infrastructure; again, a busy slide, but I'll take you through it. If you start at the bottom left, what you see is residential broadband connectivity. We see business customers, we see wireless customers here on the bottom. And what you see is the network is converging. It's converging to an IP Ethernet converged core and mobile backhaul network that's coming all together. And there's a lot of money being spent on these edge routers to combine this traffic and bring it into a single core, lowering cost within the network and creating support or opportunities for service providers to create more services on the edge of the network.

And then, when you go through the network, what you see on the far end of the network is multi-play services. So they're representing voice, data, video services and hosting areas here. You see third party Cloud computing environments, so think of YouTube or Amazon; then you have private Cloud, which is really just a new designation of data center, so large enterprise data centers inside this network. And what you see is that Spirent tests across this entire portfolio, or this entire network of solutions.

So whether you start at the application, performance and qualitative experience to the actual end-user, if you look at our in-home field test products, the testing of the mobile devices themselves, the mobile backhaul, the satellite receivers, again, as location-based services and global positioning becomes part of everyday life, air interfaces on base stations, how well a mobile device connects to a base station, Ethernet service assurance inside the live network, the enhanced packet core, again, combining mobility and wireless inside the same core network,10 gigabit, 40 gigabit Ethernet inside the data center, along with virtualization and converged Ethernet, bringing storage and Ethernet together inside the data center, 10 gigabit and 100 gigabit inside the core of the network for service providers, always with Cloud, the performance, availability, scalability, security of Cloud computing, and what we're seeing is our customers continue to request a breadth and depth of portfolio, one of the unique strengths of Spirent, to test across all these dynamics.

Because today people want access to YouTube or to third party Cloud computing sites, whether they're on residential broadband, at their business, or on a mobile device, no matter where they are in the world. And this testing across all these devices and across the entire network is what customers continue to request from Spirent. And we can leverage our broad breadth of portfolio of test products to test across this entire environment.

This is a slide really talking about how Spirent's been recognized in the first half year, and continues to be recognized by our customers, and by the industry, for awards and wins. I'll just pick out a couple of these.

Extreme Networks chose Spirent to demonstrate their 40 gigabit Cloud computing based routing products, switch and routing products, that they brought to the market in the first half year. China Mobile; the test fiber channel over Ethernet, the combination of storage and Ethernet together. Crossbeam was to test their new security product being brought to market.

Best in Test was an award actually focused on our mobile backhaul solutions; so taking our Spirent test center, our flagship wireline test product, and adding mobility testing to that product. Time of Test (sic - see slide 19) was actually an award we received around combining CDMA, UMTS and LTE testing on the same test solution for wireless devices.

LT Awards; we were a finalist in the area of location-based services. So, again, taking our wireless test solutions, marrying those with our global positioning test solutions and testing true applications within side the global positioning or location-based services arena.

But we continue to be recognized by our customers and the industry, as wins and awards across the industry.

This slide is really -- there's two slides in this area, and it's really to show why we fundamentally believe the market drivers inside telecom and IT will continue for some time.

This is a chart that shows 3G-enabled device revenues that are actually declining between 2011 and 2015, but the forecast in shipments of actual units, the actual devices themselves, will increase in this time period. So when you think about that, there'll be more devices brought to market, because the shipments of devices will continue to grow, despite the revenue declines.

But what the real important part of this slide is, that you marry this, more devices sold, even though there's lower revenue, with the increase in revenue associated with LTE-enabled devices. So the growth of LTE devices being built in the network, and the complexity of those devices, that have to support CDMA, or UMTS, Wi-Fi, location-based services, all the connectivity requirements of an LTE device, which is much more complex than a 3G device today, is going to continue to grow considerably.

And again, this is why we look at the industry and say this is just at its infancy. A lot of talk about 4G, a lot of talk about LTE. The growth remains in 3G devices over the next couple of years, and tremendous growth associated with LTE devices. So just at their infancy today.

Second example of this is 10 gigabit Ethernet, versus 40 gigabit or 100 gigabit Ethernet. So today, 10 gigabit Ethernet switching or routing revenues to our largest customers projected to grow between now and 2015. And you see tremendous growth associated with 40 gigabit and 100 gigabit. But it's infancy today.

So a lot of focus on the network equipment vendors today, our fastest growing test interface today, is still 10 gigabit. And lots of growth to come, and lots of opportunities for Spirent, as well as the network equipment vendors, in upgrading the network to 40 gigabit and 100 gigabit.

And earlier this year, the expectations of optics and 1,400 gigabit got a bit ahead of itself, as we're just seeing this become deployed in the data center, and inside the service providers worldwide. So lots of growth left within multiple technologies that we've been talking about for a long time, that are just beginning to grow within the industry overall.

Summary -- positive momentum continues across the communications industry. We continue to invest for future organic growth in the new served markets. So we're growing our current portfolio, as well as evolving into new markets. Our focus is really on maintaining best-in-class profitability, coupled with top line growth; so growing the top line of our business. And we believe we're well placed to continue to achieve further progress in the second half year, in line with our original expectations set for the second half year.

So with that, Eric and I will take questions.

QUESTIONS AND ANSWERS

Gareth Jenkins - *UBS - Analyst*

A few, if I could. I just wondered, on the LTE revenues, how much of that's coming from your existing CDMA customer base, and how much of it's coming from new GSM WCDMA customers?

And then second, I just wondered if you could give us a bit more color on the splits between NEMs operators and government in the half? And also, geographically, where you're seeing strength in maybe some of -- you mentioned the US, but are there any other areas where you may be seeing some weakness in wireline? Thank you.

Bill Burns - *Spirent Communications plc - CEO*

Start with LTE. I think that LTE revenues are coming from all of our customers, quite honesty. So we're seeing that the evolution of Spirent test center to add LTE mobile packet core requirements of testing, as well as the mobile backhaul requirements, inside Spirent test center. So we're seeing traditional wireline switch and router customers buying our wireless test solutions today to enter the mobile backhaul area, especially focused around LTE environments.

We're seeing just as much requirements today on the UMTS side as we are on the CDMA side for LTE, as customers like AT&T look to deploy LTE in the US market. So while we had success of Verizon around CDMA, and I wouldn't talk down that, we're seeing a lot of requirements around LTE associated with UMTS.

Our Fader market continues to grow. So our Fader product bookings were up in the first half year; again, focused on LTE as well.

So it's really a mix of CDMA and UMTS, and probably, quite honestly, more skewed towards UMTS than it is CDMA.

The NEM breakdown, it is pretty consistent with what we've seen in the past.

Eric Hutchinson - *Spirent Communications plc - CFO*

Pretty consistent; slightly lower proportion to service providers. So proportionally, the equipment manufacturers are higher, primarily driven by growth in the LTE device testing with equipment manufacturers. They're now picking up the demand, as that was primarily with the service provider last time round. So we're about 17% on service providers, rather than being nearer 20%. Government, proportionately, is pretty much the same; 10%.

Bill Burns - *Spirent Communications plc - CEO*

And geography-wise?

Eric Hutchinson - *Spirent Communications plc - CFO*

Geography-wise, we've seen growth in all regions. Much stronger rates of growth in the European market, because you've got some major developers based in Europe, but they deploy the equipment globally. So probably not so much a macroeconomic point, as just where the ordering point is. We saw very strong rates of growth in our European business, as a result of that; primarily driven by mobile backhaul and wireless, again.

The Group grew at 15%. So China -- the Asian market actually grew 15% as well. USA itself was up around about 10%; so growing, but not as strongly. So the real growth areas for us consistently Asia, and proportionately more in Europe this time round. So USA is just under 50% of activity now, but it was running at around about 51%; with the growth coming more back to the European and Asian proportion. And we're continuing -- we've seen that growth in Asia quite consistently.

Bill Burns - *Spirent Communications plc - CEO*

Some of that's North America equipment manufacturers and device suppliers spending in Asia as well.

Eric Hutchinson - *Spirent Communications plc - CFO*

Yes, that's right.

Nick James - *Numis Securities - Analyst*

A couple of questions. One, on the investments in PA in terms of product development. I think the spending on development was up about 18%. I just wanted to understand the visibility on the return on that investment, and how the 18% growth relates to the 7% to 10% growth that you're indicating for the growth in the underlying markets?

And then, the second question was just on wireless. Wireless seems to have been a strong growth driver for a number of years now. I guess at some point it's going to slow down. How close are we to when the wireless market is getting a bit more mature for Spirent?

Eric Hutchinson - *Spirent Communications plc - CFO*

So the investment level, so we have seen revenue outpacing our increases in investment in engineering for a number of years now. So we are looking to use continued growth rates to put more back into engineering. So the rate of growth in engineering's a little bit of a catch-up, in the sense that we've now turned on more projects.

Typically, we expect to see payback on our investment in roundabout two years in terms of the actual investment itself overall, including all the go-to-market costs. Typically, you'll see revenues start to run about 18 to 24 months after the initial start of an investment project and with then accelerated growth in the first couple of years thereafter. We're looking to get multiples of revenue on the investment and successes; how many big ones can you get?.

In terms of the wireless market, I think it's a long way to run. It's been running for some time as you build out 4G, LTE. We've got continued high investment plans in expanding 3G globally. We've got continued investment in TD-CDMA in China.

So access technology is in a number of new applications driving data usage as wireless. So with the access technology in all the new devices that are coming out, it's going to run for some time.

Nick James - *Numis Securities - Analyst*

Just to follow up on the product development thing, I think before you talked about you only developed products if you saw a real customer demand, in that people were asking for it. Are you starting to do things a little more speculatively now? Or is it still very much customer driven?

Bill Burns - *Spirent Communications plc - CEO*

It's very much customer driven. I think that we believe that beyond the current opportunities we have, we can expand into some new served markets that are adjacent to the markets we're in today; so make some investments into those areas to expand our served markets.

As Eric said, today we've got best-in-class operating margins. And we believe that the right thing to do is keep return on sales where it's at today and reinvest the profits from the top line growth in the areas where we can continue to drive top line growth for the business, because we don't want that growth to stall; we want that growth to accelerate over time.

So we think there's enough opportunities across the telecom and IT infrastructure today that are going to remain for some time in the next three to five years, probably longer than that, quite honestly, as you see all the technologies are slower to the climb than one would expect and newer technologies take longer to roll out. There's a lot of opportunity for us to expand into new markets and, quite honestly, we see the opportunity to do that.

Nick James - *Numis Securities - Analyst*

Great, thank you.

Phil Smith - *Fairfax - Analyst*

Regarding the Ethernet switch market, there's been, at the start of this year, quite a few changes. I think Cisco's seen some pressure there from HP in the market. And there's been a lot of pricing pressure as well and support sales have slowed down single digit. Can you talk about what impact that's -- have you seen any impact on your sales from that?

But also, what's happening to development spend in the area? If there's a lot of price pressure competition on a particular product, maybe that's forcing through more development. Don't know, what are your comments on that?

Bill Burns - *Spirent Communications plc - CEO*

Yes, I think we've seen for some time now that the core switching routing market's not growing. So while we sell a fair amount of ports, because it's a large market, our Performance Analysis business -- piece of Performance Analysis overall in networks and applications, it's probably 20% of that 60% of the business; that's in core routing and switching.

But money's really being spent by the network equipment vendors on new Cloud computing platforms, new edge devices, edge routers to add mobility to the routers they have today.

So while the spend continues, it's pretty flat. So that's when we look at the dynamics of our portfolio and you take Performance Analysis and then you cut it down to 60% networks and applications, you take another 20%, which isn't growing all that much, but the remaining part of that business, the other 80%, is really focused on the areas where people are spending money.

So while it's a large market to us, it stays pretty consistent. There's not a lot of spending in core switching and routing. The spend is really around enhancing those core switching and routing products to add mobility, moving to virtualization with new areas within -- people like Cisco want to compete in new areas with HP and Dell and others. It's around adding mobility, so Alcatel adding mobile functionality to their edge routing devices.

So that's where we see the spend in switching and routing. It's really on enhancing the edge routers for the network. And then those routers going inside the data centers versus core switching and routing, which, you're right, is under a lot of pressure today.

Phil Smith - *Fairfax - Analyst*

Just a second question on US Government spend, apparently the US Government is planning to cut the number of data centers that it has and it's quite a long-term program. What's happening in that area? Are the data centers are consolidating into existing US Government ones? Or they outsourcing more work and that's causing spend in another area?

Bill Burns - *Spirent Communications plc - CEO*

Yes, I think there's been pressure on US Government spend and Cisco have said that for some time now, pretty publicly. I think Juniper's seen the same as of recently.

I think that's why you're seeing some of these moderating growth rates, is that while growth rates were in the 15% to 20% range, they're moderating down to the single digits, the 10% to 12% to 14%. I think it's driven by that.

The US Government took a long time to pass the budget this year, well under their budget cycle. And they spent a lot of time figuring out what was going to happen with the debt. So we'll see. The fiscal year ends October 1 and we'll see whether some of that spending comes through at the end of this year.

I think the general view is that defense spending will be down in the US over the next couple of years. So I think that, like every business, the network equipment vendors selling into that space will shift their focus more to enterprise and more to service provider and look to grow in other areas. I think that's probably what's going to happen. I think probably US Government spending is going to be down a bit.

Zahid Hussein - *Citigroup - Analyst*

One of your major rivals obviously had a bit a shocker this quarter and has really blamed that on a slowdown in US as well as APAC. It looks like your APAC revenues are up. I wanted to know if you could discuss market share changes at all, whether you think you've been taking share in APAC specifically and why. And I've got a couple of follow ups to that, thank.

Bill Burns - *Spirent Communications plc - CEO*

I think that we saw -- in the first half of the year, we saw a recovery in the market in 2010 and in the first half of 2011. And I think that people probably got a bit overexcited on growth rates and expectations in the market. And I think that we've consistently said we can grow our business at 7% to 10%.

I think that we've got a strong presence in Asia. We've said that for a long time and we continue to grow our business in the Asia market.

We've seen a bit of caution in the North America market, primarily around these growth rates coming down. So, to us, it's more growth rates are moderating to a level that's more normal levels after very high recovery numbers than anything else, and it's causing just a bit of caution.

So I think that we believe we did well on Asia through the first half of the year. We think we'll continue to do well on the Asia market, as we've done in the past.

North America, I think we'll be a bit of caution in the second half and that's why we've said we're comfortable with the current guidance we have and the numbers are up in the market, which is the 7% to 10% numbers for the second half year.

I think that we'll always have (inaudible) competitors in the market and they'll always be out there and we'll continue to work with our customers to continue to win their business.

Zahid Hussein - *Citigroup - Analyst*

Do you think you've actually taken market share or --?

Bill Burns - *Spirent Communications plc - CEO*

I think it's hard. I think it's better you're talking about we've split the market in many areas, so we've split the Ethernet market and many of our customers use both, ours and their products. So while we did well in the Asia market, it's hard to really determine. I think the -- we'll see.

Zahid Hussein - *Citigroup - Analyst*

I'll take that as a yes. (laughter) And just in terms of second half guidance, it seems to me that to make the 7% to 10%, you don't need to do a great deal. But clearly you're (laughter) -- you're clearly thinking that wireline is either going to drop off a cliff or wireless slows down. Is that the right way to interpret that? Or should we think there's a little bit of upside to that 7% to 10%.

Bill Burns - *Spirent Communications plc - CEO*

I think it's a little early to tell. I think that we've only seen over the last four to six weeks this bit of caution. And the caution, again, I believe, is driven by very high expectations coming down to more realistic expectations, as opposed to -- people are still predicting growth in the second half year across telecom and IT. There's no doubt in my mind.

I think that if we look at the portfolio, we've said for a while that the portfolio adds up to 7% to 10%, which if you take our Networks Applications business and marry higher growth rates of Wireless and Positioning on top of it and it comes to 7% to 10%. And that gives us confidence in the second half year. It's this diversified solutions portfolio and our broad customer base. Because some customers are going to do well and others aren't going to so well. That gives us confidence in the second half. There's not much more to it than that.

I think that it's our customer relationships. I think that we are doing well across all geographies. We feel good about that. I think that we'll continue to grow all of our businesses and, as we look at the numbers and roll them up from the sales team, are they telling us they're seeing a bit of a caution in North America? Yes, but they still feel pretty good about the numbers.

So we've rolled this up a bunch of times now and we still come back to the same numbers. I think that you saw us be pushed the second part of last year on why aren't the growth rates higher? I think that what you're seeing is a lot of people moderate down to the growth rates that we projected, quite honestly. (inaudible) --

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Zahid Hussein - *Citigroup - Analyst*

Okay. And just one more on --

Bill Burns - *Spirent Communications plc - CEO*

We're still good.

Zahid Hussein - *Citigroup - Analyst*

Okay. And just on your growth strategy, there seems to be a bit more talk around where you're looking and it seems to be a bit more of a bullish tone from you guys. Clearly nothing to share with us yet, but if you can give us a little bit of color as to the areas you're looking into.

And specifically, we've seen sales and marketing go up somewhat more than what I expected. Is that because you see more growth in the channel? Or is that really to get ready for the next products coming forward?

Bill Burns - *Spirent Communications plc - CEO*

Yes, I think, as Eric said, we've been holding back costs in the states of growth here and letting return on sales continue to move upwards. We now deliver best-in-class return on sales, as we've done for a long time, quite honestly, in test and measurement, and we -- as we've seen other people's expectations come down, we're have a shining star on return on sales. So we believe the right thing to do is make some investments.

On the sales and marketing side, it's all about our biggest customers. So it's quite honestly about our biggest customers. So it's, quite honestly, about investments in channel focused on the largest customers, all the ones you'd expect. So it's Alcatel, it's Cisco, it's Huawei, it's ETE. It's about putting more resources focused on our large customers.

On the R&D side, we think there's some opportunities in the market to expand in adjacent markets where we don't play today. We've talked about the breadth of our solutions portfolio and wireless, and we believe we can expand this to new adjacent areas in wireless, beyond what we do today. So we're going to invest some dollars associated with that.

We believe that combining our mobility test solutions around wireless packet core and our Spirent Test Center product together, is really a need in the market today, to test performance and the mobile packet core together, as they're converging together. So these opportunities are giving us confidence that if we make these investments now we'll drive future top line growth across the business.

So those areas we're investing, in the largest customers in the sales side, and really around new adjacent markets, and continuing to evolve our current solutions. There's a lot of work to be done still on LTE, there's a lot of work to be done on 1,400 gigabit Ethernet. And on application tests, our core development continues. But those investments, we think, are prudent.

We really believe that the fundamentals within the telecom and IT market will remain strong over the next several years. It doesn't mean there won't be a blip along the way. It doesn't mean the second half year won't be marked with some caution. It doesn't mean that the macroeconomic environment isn't weighting on everybody's minds. But the fundamentals remain pretty strong, and that's why we feel good about our business. But we felt it was prudent that to flag the tone of caution we're seeing from some of our customers towards the end of second quarter here.

Unidentified Audience Member

(inaudible) from Collins Stewart. Just two questions. What's -- can we have the updated split of Networks and Applications, Wireless and Positioning?

And the other one is, when you're talking about adjacent areas, is there a bias more towards software, hardware? Can you give us a bit more color on that? And that's the two questions.

Eric Hutchinson - *Spirent Communications plc - CFO*

In terms of revenue proportion, it's broadly similar; but there's been a slight decrease proportionally in Networks and Applications. Last time round we said at 63%; it's a bit closer to 60%. And the pickup is all in the Wireless area.

Unidentified Audience Member

So within that 4G, could you split that out as well?

Eric Hutchinson - *Spirent Communications plc - CFO*

4G?

Unidentified Audience Member

LTE, sorry, LTE.

Eric Hutchinson - *Spirent Communications plc - CFO*

LTE, 4G? It's around 20% of total PA revenues, and that's a combination of device testing and the backhaul build out.

Bill Burns - *Spirent Communications plc - CEO*

On software and hardware, I think the -- for time we've said that the value of our test solutions are all in software. But our customers like to buy hardware and software test tools, they like the package. Even if it's a software test tool, they like it given to them on a server, fully-functional, in a way that they can use it as a test tool as opposed to them integrating that software and hardware together.

So all the value's in the software. We have very high gross margin, primarily because we're selling technologies, the very leading edge of technology and development, when our customers need them. So we spend about 20% in R&D, 18%, I think, in the first half year, and our model would be to spend about the same on sales and marketing, primarily to stay close to our customers and work with them with our fairly high-technology, high-touch products overall. So our cost base is relatively high in proportion to that.

So even our hardware products we're seeing high gross margin, primarily around the idea that I've got to develop technologies ahead of the curve and stay really close to my customer to make sure they can use those technologies to bring out new products to market. But the value's all in the software.

Unidentified Audience Member

Thanks. Just a couple of follow ups, I guess. One, I just wondered if you could give us a bit more on this intangible CapEx and what the margin impact is on the LTE business going forwards?

And then secondly, I just wondered, Bill, you mentioned the fact that you're seeing more converged technology coming through. Does that mean that you end up with quite a radical shift in your customer base, as some of your customers have combined product, and others clearly don't?

Eric Hutchinson - *Spirent Communications plc - CFO*

The intangible asset on the LTE side, it means that we now have the rights to manufacture the network emulator product that we were buying as a third-party supply. So we're passing that through at just a modest mark up on that supply. That means that the wireless device test margin on the LTE product was below average.

This purchase of the IP, after amortizing that IP through cost of goods sold, will put us back on to our normal margins for the product area. So it's a small proportion of revenue initially, but it means that as you see more growth in LTE test it will be at our normal gross margin.

Bill Burns - *Spirent Communications plc - CEO*

As for convergence, I think that more than anything it creates more opportunities for us. So as we're seeing the addition of -- you saw a couple of acquisitions in the market around convergence, so Tellabs bought WiChorus and Cisco bought -- I want to say Clarion, but that's not right -- it's Starent, and the Starent acquisition by Cisco, and just organic investments by Alcatel, to take what was wireline switch and router products, we talked about before, and add mobility and type functionality to them.

So that's just one example of the many areas we're seeing of convergence of technologies, where now Tellabs is buying both our wireless test solutions around mobile packet core, married with our applications test solutions and our Spirent Test Center product. We're seeing that same dynamic from -- in Alcatel area, that would just buy our switching and routing test products in the past, Spirent Test Center, they're buying both.

So we're seeing these dynamics in the industry, where it's creating more opportunity because the complexity of testing is increasing. Now they don't need just to test a device for switching routing; they've got to test it for the applications it supports. They've got to test it for mobility. They want to test it in multiple applications, so they're taking the same switching and routing product and changing it, and moving it into a Cloud computing environment. So, if anything, it's creating new opportunities for us to test in different ways, or test the convergence of technology in the same devices. So we look at it as more of an opportunity than anything else.

We're also seeing some startups in this space, so you're seeing some smaller startups in the network equipment side, focused on certain areas; security, your applications performance. Those also create some new customer opportunities for us.

Typically, consolidation isn't our friend. In the case of those two acquisitions I mentioned they have been, meaning both were good customers and now they're buying more from us combined than they were in the past, as they invest in those technology areas to really grow their business. Convergence actually is a friend of ours. And the fact that we've got the breadth of solutions to cover that convergence is another -- really combining assets together, as opposed to having to acquire them or develop new assets.

Unidentified Audience Member

Any general comments on the pricing environment as you close the quarter?

And then there's a quick follow up. Given modest rating growth, anything we should think about in terms of revenue phasing for Q3, Q4?

Eric Hutchinson - *Spirent Communications plc - CFO*

The pricing environment really hasn't changed. It's always been highly competitive when it needs to be, but the dynamic is no different now than it has been for the last (inaudible - technical difficulty) years, quite frankly. The wireless market is pretty hot. Got lots of people trying to get business in LTE, but everybody's operating at pretty normal pricing models, quite frankly.

The activity levels, in terms of revenue Q4 is seasonally our strongest quarter. We would expect that to be the case this time round. We are expecting to see growth in that period.

Order intake, the phasing of order intake in 2010, we continued to see very strong demand levels in order intake in Q3 2010, and the rate of growth actually slackened in Q4. So, paradoxically, it's a harder comparative on order intake in Q3 than it was in Q4. So that's about where we are.

Unidentified Audience Member

Just a couple of housekeeping ones on customers. Usually top 20's about 40%, 45% of revenues, I just wanted to know if there's been any change to that, in terms --

Eric Hutchinson - *Spirent Communications plc - CFO*

Last year was actually 54%.

Unidentified Audience Member

54%.

Eric Hutchinson - *Spirent Communications plc - CFO*

And it's now about 52%.

Unidentified Audience Member

Okay. And in terms of the actual mix and that, has there been much change? Is there any 10% customers, or anything like that?

Eric Hutchinson - *Spirent Communications plc - CFO*

No. No, 10% customers. As I said earlier, the decreases, or the slower growth rates, were service providers. So you're seeing some of the big equipment manufacturers getting up into the top five. The top five are about 24% of revenue.

Unidentified Audience Member

And cash taxes for the rest of the year?

Eric Hutchinson - *Spirent Communications plc - CFO*

Cash taxes for the rest of the year --

Unidentified Audience Member

And first half.

Eric Hutchinson - *Spirent Communications plc - CFO*

First half was $12.6 million. I'm expecting that to be in the region of $15 million to $17 million, cash tax, second half. Okay? Any more?

Bill Burns - *Spirent Communications plc - CEO*

Thank you, everybody.

Eric Hutchinson - *Spirent Communications plc - CFO*

Thank you.

Operator

That concludes our conference call today, ladies and gentlemen. Thank you for your participation. You may disconnect your lines.