FTI CONSULTING GROUP LTD

Moderator: Eric Hutchinson
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Operator: This is conference # 36498564.

Ladies and gentlemen, welcome to Spirent's Q1 2015 trading update.

I will now hand over to Mr. Eric Hutchinson, Chief Executive Officer, and Ms. Rachel Whiting, Chief Financial Officer.

Eric Hutchinson: Thank you very much. Good morning, everyone, and thank you for joining the call.

We've given the trading update today on the first quarter's performance. As we highlighted at the yearend results' announcement, we expected to see a slow start to 2015 after the very strong finish in 2014.

New business was slightly down by $2.3 million against last year, resulting at $99.4 million.

We saw growth in the wireless service experience and service assurance segments but weak demand for networks and applications, particularly during January and February, more than offset this. Although demand for networks and applications came back strongly in March, it wasn't sufficient to offset the slow start.

Regionally, we did see good growth in North America, up 7 percent, but delays in demand patterns in Asia and Europe offset this.

We have seen a strong recovery with a key equipment manufacturer in the quarter. Our participation in a large number of proof-of-concept trials for virtual technologies gives us confidence that we will see growth in major service providers during the remainder of 2015.

Regionally, both Asia and Europe see improved prospects in the second quarter.

The impact on revenue for the first quarter was exacerbated, in comparison with the first quarter of 2014, as this period included $12 million for the shipment of handheld test tools. There is a further $16 million contract for these in 2015 but it's not expected to ship until the second half-year.

We have increased the resources working on new growth initiatives in the Group, so our cost base is higher in 2015 when compared to 2014. As a result, we've incurred an operating loss of $3.6 million in the first quarter of this year.

Cash generation was much improved at $12.5 million, compared to $2.9 million last year.

Looking forward, we see stronger order activity trends coming through in the second quarter and we anticipate improved growth rates in the second half-year.

With the high operational gearing in the business, this has a much greater benefit to operating profits. Hence, we remain confident that further progress will be achieved during 2015, broadly in line with our expectations. More importantly, the long-term value for Spirent continues to be enhanced.

With that summary, I'll open the call to questions and hand back to the operator. Thank you.

Operator: Thank you.

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

Once again that is star and one to ask a question.

If you find that your question has been answered, you may cancel your request by pressing the hash key.

Your first question comes from the line of Gareth Jenkins from UBS. Please ask your question.

Eric Hutchinson: Good morning, Gareth.

Gareth Jenkins: Yes, morning.

I just wondered whether we could talk about the growth expectations into the back nine months of the year. I think the outlook says broadly in line and I suspect that means that you're expecting an acceleration in growth from here. But maybe you could just give us a bit more detail around that and maybe what gives you confidence in that, whether you're seeing something in the pipeline that gives you confidence over and above the handheld test tool.

And then secondly just on gross margins, I wonder if you could give us some color around gross margins in the first quarter and how that trends through the year and maybe some of the acquired OpEx that you may have brought into the business. Thank you.

Eric Hutchinson: OK. Three-part question there. The growth rate being expected or we talk about for the year. If I look at expectations out there, we're high-single-digit growth on a full-year basis. Clearly from here that means we need to see stronger growth rates near term.

As I look into the second quarter prospects and a pretty good start during April, we'd expect to be in double-digit growth rates for the second quarter.

An awful lot of the new product introductions and some of the projects by service providers, which give us fairly meaningful software contracts, are certainly being scheduled for Q2, Q3, Q4. Hence the confidence we have that we should be able to achieve those high-single-digit growth rates upon the full-year basis.

Regarding the gross margin, we actually saw the gross margin firm up and improve during the first quarter compared to the first quarter of last year. So we are ahead of last year.

Interestingly, with low activity levels you'd normally expect the gross margin to be squeezed a bit but, in fact, we've seen an improvement and that's without any significant change in the mix from software contracts. So product margins have been quite robust.

And regarding the acquired businesses perhaps, Rachel, you could take that one.

Rachel Whiting: I was going to say, going back to the gross margin we're expecting to see a steady improvement in that through the rest of the year as we do start to feel a bit more benefit from software in the mix. So, as Eric said, we saw firming up in Q1 over 2014.

In terms of the acquired OpEx, as Eric said, we saw some increase in the OpEx in Q1 as a result of the acquisitions coming in. So really our increase in OpEx for that quarter was driven by the acquisitions. And that will continue through for the rest of the year so we get the full-year impact from the acquisitions coming through.

Apart from that, we do have a little bit of change in the OpEx where we've gone direct with some of our moving from channel to direct sales. So you see that moving from the gross margin into the OpEx margin.

Eric Hutchinson: And, just to remind everyone, we stepped up the operating expenses in the business in 2014. Our plans are not to increase materially our organic investment back in the business during 2015. So most of the effect that you'll see in increased expenditure is the consolidation of businesses that we acquired.

Gareth Jenkins: Thanks.

Operator: Once again, ladies and gentlemen, it is star and one if you wish to ask a question.

Your next question comes from the line of Owen Lamb from Liberum Capital. Please ask your question

Owen Lamb: Hi there.

Just to go into more detail on the H2 weighting, I think Q1 profitability was a bit weaker than I had expected and for you to hit full-year numbers you need a very strong profitability weighting to the second half. Given, I suppose, the lack of visibility generally in this space, do you believe this is a bit of a risk? Or do you believe you can still hit consensus roughly in the second -- with a very strong H2?

Eric Hutchinson: It is definitely (known).

In terms of the weighting in the business, I think the guidance we've given is that the revenue split would look something like 45 percent of revenue in the first half year, 55 percent in the second half year. We wouldn't change that view based upon a slow start in Q1. We still expect to see that sort of ratio.

As our gross profit margin is nearly 70 percent, then that change of the weighting to the second half drives the profit up considerably. And you've seen that in past reporting periods for the Company that we have a very significant increase in profitability when we get that sort of change in activity levels.

You're right in the sense that visibility in the industry is difficult in quite short term. But, because we're working closely with quite a number of major service providers and major equipment manufacturers, we can see their plans for new product introductions and launches.

We can also see that the trials that they're running on new technologies in proof of concept is stepping up. And we believe that we have solutions that are very attractive. We're getting very positive feedback from customers.

So we believe, although there's risk, there's always risk in any projection, that we're very well placed to achieve the consensus numbers as people have got them.

Owen Lamb: OK. Thanks. And just if I take a step back, given -- do you still think Spirent should grow at high-single digit, given the changes and the structure of your end market? Is 8 percent or 9 percent still roughly the top-line growth we should expect for Spirent?

Eric Hutchinson: Over time, that's certainly our intention. The more that we see the trends in our customers and technologies we believe 2016 actually should be a very attractive year for the Spirent portfolio.

Competition are having a very mixed experience in the sector at the moment. There's a bit of sector consolidation going on, which can reduce the size of the pie. But, on the other hand, everybody is looking at introducing more and more capability into delivering data communications.

We've got all of the challenges of security threats to operations. We've now got threats to satellite navigation signals. And we've got a whole build-out of a new wireless infrastructure with new technologies. And we're very well placed to serve those needs.

So we still remain confident that we should see a growing business in what may be a quite challenged end market.

Owen Lamb: OK. And then just one final question on consolidation. With consolidation in the network equipment manufacturer, Alcatel-Lucent and Nokia, does that change your view on what it is the test and measurement space would benefit from consolidation?

Eric Hutchinson: So there's probably a consolidation theme across the industry and the test and measurement sector.

I think, as I said at the yearend, there are more independent, pure-play test and measurement businesses out there, which have been spun out of larger conglomerates or businesses splitting themselves in two. A lot of those things have been in the public arena. And that's still being digested so we haven't actually seen that consolidation activity level in test and measurement itself pick up as yet. I would anticipate that it will probably through this year.

Owen Lamb: OK. Thank you very much.

Eric Hutchinson: OK, thank you.

Operator: Your next question comes from the line of Arun George of Canaccord, please ask your question.

Arun George: Good morning. I just have one question. In terms of the strong order growth in North America, the 7 percent growth that you put in the statement today, I was just trying to understand, I guess, what is behind it, because it stands in contrast to what your competitor JDSU talked about in their conference call on Thursday night.

So is it to do with probably targeting different pockets of growth? Or are you gaining substantially market share? Thank you.

Eric Hutchinson: So I think, as the previous questioner made the point, there's a lot of uncertainty and volatility in the sector. The force behind our numbers is we've seen some good contract wins in the live network monitoring, which is a competitive gain. We've also seen a considerable growth with a major equipment manufacturer in North America and that's certainly gaining market share on our part.

We've yet to see some of the major service providers' spending coming back, but we know that they've got budgets and the management reorganizations settling down. So we'd expect them to start spending from Q2 onwards.

So I think the general background in the service provider market is being subdued, but we have actually made some competitive wins.

Arun George: All right. Thank you.

Operator: Your next question comes from the line of Robert Lamb from Jefferies, please ask your question.

Robert Lamb: Good morning, Robert Lamb from Jefferies, thank you for taking my question.

It was just on virtualization. We're now seeing reports of Verizon exploring SDN and NFC. Obviously, when AT&T have looked into this it's led to a pause in the industry. So how would you characterize the conversations you're having with service providers globally on this and how developed the Spirent products to meet their needs in terms of functionality or possibly even the economics if they are selling such solutions?

Eric Hutchinson: OK, good morning, Robert thank you for the question. It's quite timely. We've just announced a new virtual test solution, which we're calling cloud stress. That was announced at the Interop exhibition last week.

We've seen quite a number of proof-of-concept trials being run on NFV and SDN deployments, and we've been participating in that. I'm glad to report that, of the trials we've seen, 93 percent of service providers who have run those proof-of-concept trials are going to go ahead with deployments.

The issue with AT&T was that in the third quarter last year they totally reorganized their business. They changed the way that they were going to run testing and monitoring. They put their lab-testing activities together with live monitoring. They put a new team in place and they're setting a new set of budgets. And they clearly told everybody in the industry that they were only interested in pursuing new technology solutions. That was a very considered policy on their part.

I think that we're seeing in other service providers that are more incremental, evolutionary approach. So we're not seeing the same disruptive impacts because they're continuing to invest in current technologies whilst looking at the ways to deploy the new technologies.

So certainly nowhere near as a shock to the industry as we saw third quarter last year.

In terms of our solutions set, we're continuing to enhance our virtual test capabilities. We're winning some quite considerable virtual deployments at scale. So we're now doing things like 500,000 port tests on testing the deployment of virtual machines. And we have, as I say, a whole new approach to stressing the cloud, which is very applicable to NFV deployments. And we expect to do more of that in the second quarter and setting ourselves up for the rest of the year and next year.

Robert Lamb: OK, great. Thanks very much, guys.

Operator: Once again, ladies and gentlemen, it is star and one if you would like to ask a question.

And your next question comes from the line of George O'Connor from Panmure Gordon, please ask your question.

George O’Connor: Yes, good morning Eric and Rachel. George here.

I just wondered, what was the value of the orders that slipped in Q1?

Eric Hutchinson: Good morning George.

We saw about 5 million of business really slipping out of networks and applications. That was really the sort of shortfall. We expect to be pretty much on track again by the end of the second quarter on most of the networks and applications product lines.

George O’Connor: Would you -- I didn't have a consensus number for Q1, but would the sort of 101 kind of number hit consensus?

Rachel Whiting: Yes, there wasn't really a meaningful consensus for Q1, George. There were so few that were there, so we didn't publish any Q1 consensus.

George O’Connor: Okey dokey. In terms of the rev-rec policy, was that due to something at the customer side? Or was it due to new hurdles that Spirent has put in?

Eric Hutchinson: Revenue recognition, there's no change in –

Rachel Whiting: There's no change in our policy there.

Eric Hutchinson: -- in policies or hurdles. It's purely to do with timing of contract deployments

Rachel Whiting: Yes, that's right. Yes. Are you referring to the orders being received too late to…

(CROSSTALK)

George O’Connor: That's right, yes.

Rachel Whiting: OK. So that was purely because the orders were coming in so late in the quarter that we literally couldn't ship them out.

Eric Hutchinson: There's a more prosaic reason there, George. We couldn't actually make the stuff in time to ship it.\

George O’Connor: Right. Okey dokey. I heard your comments …

(CROSSTALK)

Rachel Whiting: … rev-rec policy.

George O’Connor: Okey dokey. I heard your comments on gross margin, but, generally, how are pricing trends? How did they progress through the period?

Eric Hutchinson: Pricing continues to be quite challenging, particularly in the wireless device test market. Everybody's fighting for share in quite a constrained market.

In terms of the infrastructure test, it's pretty normal. It's no more intense than it was. And it really comes down to if you've got a product that can substitute and you don't have deep incumbency, then it can be quite challenging. Otherwise, it's normal.

George O’Connor: Okey dokey. Good stuff. Thank you very much.

Eric Hutchinson: OK.

Operator: Your next question comes from the line of Nick James from Numis, please ask our question.

Nick James: Morning. Just a couple of questions. One on the pickup in network and applications at the end of the quarter. Was this in any particular region? Or was it global? Or was it in any particular product lines which picked up at the end of the quarter?

And I guess the second one was just if you could help us understand a bit more on some of the new products coming out in H2, which you're inspecting to drive the better revenue trends.

Eric Hutchinson: OK. The pickup in networks and applications was primarily North America. So we saw a big flurry of activity in the last few days in North America. We didn't see the pickup really in the other regions, particularly. We've seen that starting to come through in April. Again, North America was much stronger in April.

In terms of new products, well, we have the new network function virtualization cloud stress products coming through; deliverable software tools in the second half. We've got a new enhanced version of our data analytic solution, which should be done in the second quarter to drive second-half revenues.

We have also got a new virtual enhanced packet core test solution, which we will be demonstrating during the second quarter, and that will come through in the second half-year.

And we have a new virtual probe that we're launching in our live monitoring business, which will tap in, again, into any NFV deployments, SDN deployments.

Nick James: Great. Thank you very much.

Operator: And as a final reminder, it is star and one on your telephone keypad if you would like to ask a question.

Your next question comes from the line of James Goodman from Barclays, please ask your question.

James Goodman: Good morning. Thanks. A couple of clarifications from me, please. So I think the consolidation in the wireline market was mentioned, but more in terms of the general trend there. I was wondering, in terms of Nokia and Alcatel, to what extent have you factored in the weakness from those vendors? I seem to remember they're both top 10 vendors historically, but is that out of date and perhaps they're far less now?

And then maybe I'll come back with a couple of clarifications.

Eric Hutchinson: OK. The consolidation of Nokia acquiring Alcatel-Lucent, they are both in our top 10. On a combined basis they're round about 6 percent of revenue. We do sell somewhat different solutions to both of them, so there isn't a huge amount of overlap.

The risk on that type of consolidation is that there will be some sort of rationalization that happens that reduces the number of different initiatives.

But certainly the feedback that we're getting in the areas that we serve, there's a good degree of confidence from both.

Being realistic, what I've seen in the past is that when the consolidation happens, that can cause a three- to four-month buying freeze whilst everybody works out what they're going to be doing. So there's a short-term impact. And, over time, you'd expect to see a degradation in the total business from a 6 percent on a combined basis to being 4.5 percent to 5 percent. That's the type of effect we've seen in the past.

So yes, we've factored it in. Do we believe it's material to Spirent? Probably not.

James Goodman: OK, that's very clear. Thanks. So just the -- just clarifications on the phasing of the service assurance deal. Is that equally split Q3/Q4?

And I was just curious also on the condensed reporting for the quarter. Is there a rationale as to why you've taken that step now?

Rachel Whiting: So on your first point, on the handheld, we've got that in Q3, although, obviously, some may go into Q2 and Q4. But we're expecting it in Q3.

As far as the condensed reporting is concerned, so really following the change in reporting requirements. So following practice of other people and reducing the level of reporting that we're giving.

Eric Hutchinson: I think there's been a steer being given; getting too hung up on quarterly results is not particularly helpful to anyone. So we're following the trend in the industry, in this sector.

James Goodman: Sure. OK. Thank you.

Operator: And your next question comes from the line of Rahul Chopra from Citigroup, please ask your question.

Rahul Chopra: Hello, thank you.

Just a couple of questions from my side. First is in terms of the cost base. You had $71 million cost in Q1. So in terms of -- so how should we expect the cost to move ahead for the remainder of the year? Should we expect the same cost on the run-rate basis? Or are there any opportunities for cost reduction going forward?

Secondly, in terms of -- can you split out the Q1 performance by product vertical, please? Thank you.

Eric Hutchinson: OK. In terms of the cost base, as I said, year on year on an organic basis we've held it pretty flat. And we've put the acquired businesses in.

We are managing the costs according to the activity levels. So we're not seeking to expand significantly.

Having said that, we do continue to invest in expanding the business. So we are spending more money on go-to-market sales and marketing channels. You'll probably see that coming through during the second half-year but, hopefully, not at the expense of operating margin.

So, overall, I wouldn't expect to see a cost reduction unless we feel that we're not going to get the top-line growth.

Rahul Chopra: OK.

Eric Hutchinson: What was the second question, supplementary question?

Rachel Whiting: Sorry, could you repeat the second question, Rahul, sorry.

Rahul Chopra: It was, can you split out the Q1 performance by product vertical, please?

Rachel Whiting: By product vertical.

Eric Hutchinson: Well, we haven't given that degree of detail in the announcement. I think doing it on the fly is probably not appropriate.

Rahul Chopra: OK, fair enough. Thank you so much.

Operator: And there are no further questions, so I'd like to hand back to Mr. Hutchinson and Ms. Whiting.

Eric Hutchinson: Thank you very much, operator. And thank you, everybody, for joining the call. I hope you found that useful and I look forward to keeping in touch with you over the remaining time of the second quarter and we'll see what progress we make there. But certainly we're feeling actually quite confident, despite having a slow start to the year. Thank you very much. Goodbye.

Operator: Thanks to our presenters, ladies and gentlemen. That concludes today's conference. Thank you for your participation.

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