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DOX - Q2 2016 Amdocs Ltd Earnings Call

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OVERVIEW:

Co. reported 2Q16 revenues of $926m and diluted non-GAAP EPS of $0.92. Expects 3Q16 revenues to be $910-950m and diluted non-GAAP EPS to be $0.84-0.90.

CORPORATE PARTICIPANTS

Matthew Smith *Amdocs Ltd - Head of IR*

Eli Gelman *Amdocs Ltd - President & CEO of Amdocs Management Limited*

Tamar Rapaport-Dagim *Amdocs Ltd - CFO*

CONFERENCE CALL PARTICIPANTS

Amit Singh *Jefferies - Analyst*

Ashwin Shirvaikar *Citi - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Amdocs second-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded. I would now like to hand the conference over to Matthew Smith, head of Investor Relations. Please go ahead, sir.

Matthew Smith - *Amdocs Ltd - Head of IR*

Thank you, Karen. And before we begin I would like to point out that during this call we will discuss certain financial information that is not prepared in accordance with GAAP. The Company's Management uses this financial information in its internal analysis in order to exclude the effect of acquisitions and other significant items that may have a disproportionate effect in a particular period. Accordingly, Management believes that isolating the effects of such events enables Management and investors to consistently analyze the critical components and results of operations of the Company's business and to have a meaningful comparison to prior periods. For more information regarding our use of non-GAAP financial measures, including reconciliations of these measures, we refer you to today's earnings release which will also be furnished with the SEC on Form 6-K.

Also this call includes information that constitutes forward-looking statements. Although we believe the expectations reflected in such forward looking statements are based upon reasonable assumptions, we can give no assurance that our expectations will be obtained or that any deviations will not be material. Such statements involve risks and uncertainties that may cause future results to differ from those anticipated. These include, but are no limited to, the effects of general economic conditions and such other risks as discussed in our earnings release today, and at greater length in the Company's filings with the Securities and Exchange Commission, including in our annual report on Form 20-F for the fiscal year ended September 30, 2015, filed on December 10, 2015, and our Form 6-K furnished for the first quarter of FY16 on February 16, 2016. Amdocs may elect to update these forward-looking statements at some point in the future, however the Company specifically disclaims any obligation to do so.

Participating on the call today with me today are Eli Gelman, President and Chief Executive Officer of Amdocs Management Limited, and Tamar Rapaport-Dagim, Chief Financial Officer. With that I'll turn it over to Eli.

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

Thank you, Matt, and good afternoon to anyone joining us on the call today. We are pleased to report solid results for our second fiscal quarter which included revenues at the midpoint of our guidance on a constant currency basis. During the quarter we maintained our strong win rate with respect to some of the industry's most important transformation projects. We saw further acceptance of our managed services offering with strategic customers in Europe and the rest of the world, and we launched Amdocs CES 10, a major new product stack specifically designed to accelerate service providers' transition from the traditional to digital business model.

Now as usual, let me provide some regional color with a respect of our activities in the second quarter. Beginning with North America, sequential performance improved in Q2, and included encouraging signs of stabilization in AT&T discretionary spending following the slow start in the fiscal year. Regarding our outlook in North America, we continued to see opportunities to support our customers in their most strategic long-term initiatives.

Let me take a moment to expand on two of these. First, Amdocs is proud to have been selected by AT&T as a leading partner to build key components of the Domain 2.0 software program, a groundbreaking industry development that will be integral to AT&T's plan to virtualize 75% of their network by 2020. By leveraging our network-related knowledge and mission-critical software expertise, Amdocs will deliver a highly advanced and sophisticated set of products that will comprise major components of Domain 2.0 environment. Additionally, Amdocs will have the right to market solution suite globally.

Second, we have growing conviction that [rating] Pay TV operators in North America are finally contemplating IT projects which are designed to improve customer experience, streamline systems, and respond to increasing competitive environment which may result from AT&T merger with DIRECTV, the continued emergence of over the top service providers, and new market entrants like Altice.

Taking into consideration factors such as these, we expect Pay TV market dynamics to continue to change rapidly in the coming quarters and years, and we believe that Amdocs is well-positioned to benefit as these trends unfold. The initial signs for Amdocs are positive, and include our recent launch of the unified Optimum website for Cablevision. Now Optimum customers can benefit from many new engaging digital touch points and services.

To summarize North America, we are pleased with our progression in Q2, and we still expect a stronger second half from AT&T along the lines we discussed with you last quarter. We believe that the new growth opportunities such as Domain 2.0 and those in the Pay TV industry will take several more quarters to translate to revenues, and we're bullish about them. At the same time we are conscious of the many moving parts, some of which are continue to create near-term headwinds. This includes the effects of consolidation activity currently in progression, or may be contemplated among wireless and Pay TV operators.

Moving to Europe, we delivered sustained growth and secured addition new win with some of the region's leading service providers. This includes Three Ireland, a subsidiary of Hutchison Group which announced in March a five-year amended services contract with Amdocs to support its digital transformation across all lines of businesses. Looking ahead, Europe is on track to be an important growth engine for Amdocs in FY16. Although quarterly trends may exhibit lumpiness given the timing of project activity, foreign currency fluctuation and challenging macro and regulatory conditions.

Turning finally to the rest of the world, performance was healthy and as we moved highly complex projects toward production and expanded the scope and activities with existing customers. For instance Amdocs has been selected to assume responsibility for Vodafone India [post-bid] billing system under a five-year amended services model. This important deal highlights the growing strategic relationship with Vodafone Group, and demonstrates the increasing acceptance of our managed services offering in rest of the world markets.

Regarding our outlook in rest of the world, we are on track to deliver double-digit growth in FY16. Nevertheless, we are closely monitoring development in Brazil where recent macro-economic challenges are resulting in longer decision making cycle than we originally anticipated. Moreover, we remind you that quarterly trends are likely to remain lumpy given the project orientation of our customer engagements in our rest of the world market.

Now let take a moment to update you on our activities with former Comverse customers. First, we are pleased to report that we have successfully completed the post-merge integration of the Comverse BSS assets we acquired last July. Second, we continue to see positive level of customer retention and engagement. Average deal size are naturally smaller in comparison to our core business, but the total available pipeline is significant.

During Q2, Sky Italia upgraded its billing system to the latest Amdocs Kenan release, version 3.0, and assigned Amdocs and to end responsibility to the program with multi-year maintenance contract. Additionally, we are encouraged to see many services opportunities with former Comverse customers such as the five-year contract we announced today with Botswana Telecommunications. Overall, we are pleased with our regional performance for the first six months, especially given the challenges of the global macroeconomics and industry environment.

We are also on track with our operational performance, and we are quite satisfied with the recent track record of stable profitability we have delivered. Non-GAAP operating margins are fluctuating at the end of our long-term target range of 16.2% to 17.2%, in line with our guidance from the start of the fiscal year. This reflects our focus on maintaining consistent execution as we deploy record number of complex transformation projects worldwide.

As we said last quarter, projects such as these are quite challenging and sometimes come with a profitability below the Company average. Nevertheless, these activities provide the base and foundations on which we can secure additional business in subsequent deals to drive long-term growth.

An example of our ability to smoothly expand our activities and bring additional business value to customers is Vodafone Netherlands where in 2012 we modernized the full BSS tech on CES 8.1 primarily to support post-paid customers. In subsequent years, we enabled integrated prepaid capabilities by adding [turbocharging], then upgraded enterprise and [re-tester] systems, and delivered the complex OSS Consolidation to production. Looking ahead, we believe we are well-positioned to bring multiple functionality to support Vodafone Netherlands cable joint venture with Ziggo, a subsidiary of Liberty Global. In summary, through continued system and service upgrades only, we were able to support our customers and their ever-changing business needs.

Finally, I would like to update you with our latest thoughts on capital allocation which as you know is subject to be constantly reviewed as part of our strategy to enhance shareholder value. As we discussed last November, over the previous three fiscal years we returned approximately 80% of our free cash flow to shareholders by executing in our share repurchase activities at levels well above the -- that's suggested by our 50/50 framework. We found we could do that while still supporting our strategic initiatives, and we indicated that we would plan to maintain a fairly similar philosophy to our capital alllocation in FY16.

Since then our visibility, with respect to activities at AT&T and continued business momentum at Comverse, has improved. Additionally, we are tracking towards the midpoint of our full-year target of non-GAAP earnings per share growth of 3.5% to 7.5%, and our cash balance is healthy as a result of robust free cash flow generation and recent stock option exercise.

With these conditions in mind, we plan to increase our capital return to shareholders to roughly 100% of free cash flow throughout the second half of FY16. Which we believe we can do without significantly affecting our capacity to execute M&A as another vehicle to support our strategy.

This decision is consistent with our ongoing commitment to disciplined and [practical] allocation of cash, and our the balanced philosophy of 50/50 framework. We will update you on the longer-term plans for capital allocation when we provide guidance for FY17 in November.

Of course, we retain the option to exercise flexibility, and will vary the actual level of [shareholders] from quarter to quarter depending on factors such as outlook for M&A, financial markets, and the prevailing industry conditions. With that I will turn the call over to Tamar.

Tamar Rapaport-Dagim - *Amdocs Ltd - CFO*

Thank you, Eli. Second fiscal quarter revenue of $926 million was within our guidance range of $905 million to $945 million and included a negative impact from foreign currency fluctuations of approximately $1 million relative to the first fiscal quarter of 2016. Our second quarter guidance range had included a marginal sequential impact from foreign currency, so revenue performance was therefore I believe [point of our] expectations after adjusting for foreign currency fluctuation.

Our second fiscal quarter non-GAAP operating margin at 17.1% represented an increase of 10 basis points compared to the first fiscal quarter of 2016 and towards the high end of our long-term target range of 16.2 to 17.2. Below the operating line, non-GAAP net interest and other income was $1 million in Q2, reflecting positive contributions from foreign exchange. For forward-looking purposes we continue to expect the non-GAAP net interest and other expense in the range of a few million dollars quarterly due to foreign currency fluctuations.

A look at non-GAAP EPS was $0.92 in Q2 compared to a guidance range of $0.84 to $0.90. Foreign exchange gains, which are included in net interest and other income, and a slightly lower effective tax rate, positively impacted diluted non-GAAP EPS in Q2.

With respect to Q3, we expect the non-GAAP effective tax rate to be in the high end of our target range of 13% to 16%. For the full FY16, we expect our non-GAAP effective tax rate to be within our target range of 13% to 16%.

Free cash flow was $91 million in Q2. This was comprised of cash flow from operations of approximately $118 million less $27 million in net capital expenditures and other. This result includes an annual cash bonus payment for the prior fiscal year consistent with our guidance last quarter. Additionally, we remind you that we expect free cash flow to convert at the rate more on par with our expected non-GAAP net income in FY16.

DSO of 74 days increased by two days quarter over quarter. This item may fluctuate from quarter to quarter. Total unbilled receivables increased by $9 million as compared to the first fiscal quarter of 2016. Our total deferred revenue, both short and long term, increased by $14 million sequentially in Q2. As indicated in the past, both of these items may fluctuate from quarter to quarter.

Our cash balance at the end of second fiscal quarter was approximately $1.2 billion. A 12 month backlog, which includes anticipated revenue related to contracts, estimates revenue for managed services contracts, letters of intent, maintenance, and estimated ongoing support activities was $3.1 billion at the end of second fiscal quarter, up $10 million sequentially from the end of the prior quarter.

During the second fiscal quarter we repurchased $101 million of our ordinary shares under our $750 million authorization plan. We have $60 million remaining out of that authorization as of March 31. And we also have an additional $750 million authorized pursuant to our February 2016 share buyback program to be executed at the Company's discretion going forward. That additional authority does not have a stated expiration date.

Now turning to our outlook. We expect revenue to be within a range of $910 million to $950 million for the third fiscal quarter of 2016. Embedded within this guidance is a positive sequential impact of approximately $5 million from foreign currency fluctuation as compared to Q2.

For the full FY16 we expect total revenue growth slightly below the midpoint of our previously guided range of roughly 2% to 6% on a constant currency basis. This outlook incorporates a pickup in discretionary spending of AT&T, and continued business momentum with former Comverse customers, as well as various risks and unknowns, including global macroeconomic challenges and the effects of consolidation activity in North America.

On a reported basis, revenue growth is also tracking slightly below the midpoint of our previously guided range of 0.5% to 4.5% for the full fiscal year. Consistent with our previous guidance this range includes an anticipated drag from foreign currency fluctuations of about 1.5% relative to the exchange rates prevailing at the end of our fourth fiscal quarter 2015.

Incorporated within this outlook and consistent with our prior expectation, we anticipate revenue from our directory business in FY16 to place a drag of less than 1% on the total Company results. We continue to anticipate the non-GAAP operating margin for FY16 to be at the higher end of our long-term target range of 16.2% to 17.2%. As a reminder, operating margins may fluctuate within our long-term target range from quarter to quarter.

We expect the third fiscal quarter diluted non-GAAP EPS to be in the range of $0.84 to $0.90. Our third fiscal quarter non-GAAP EPS guidance incorporates an expected average diluted share count of roughly 152 million shares and the likelihood of a negative impact from foreign exchange fluctuations in non-GAAP net interest and other expense.

We excluded the impact of incremental future share buyback activity during the third fiscal quarter as the level of activity will depend on market conditions. For the full fiscal year we are on track to deliver non-GAAP EPS growth for the midpoint of our previously guided range of 3.5% to 7.5%. Our full-year EPS outlook, that factors in expected repurchase activity over the year.

As Eli indicated earlier we plan to return approximately 100% of free cash flow to shareholders, full share repurchases, and dividend payments in the second half of FY16. With that, we can turn it back to the Operator to begin our question and answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Ashwin Shirvaikar, Citibank. Ashwin, your line is open. Can you check your mute button? He may have left the computer; we will move on.

Jason Kupferberg, Jefferies.

Amit Singh - *Jefferies - Analyst*

Hello. This is Amit Singh for Jason. Thank you for taking my question. Just quickly on your overall guidance, first thing I wanted to check is what is the organic revenue growth expectation over there? Has anything changed in the contribution that you are expecting from Comverse for the full year?

Tamar Rapaport-Dagim - *Amdocs Ltd - CFO*

No, not significantly. As we indicated in the beginning of year, we thought it would take some time until we start seeing the app sell and synergy opportunities, just given how naturally sell cycles work. So we are seeing the business momentum picking up. We are happy about where we are seeing the pipeline. We just talked about a couple of examples of new deals we are seeing. So I would say roughly in line with what we thought in the beginning of the year.

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

And also the encouraging thing there with Comverse is that we came up with -- like Kenan going digital, basically offering extension of the Kenan offering with the new digital components from the CES spec, which is a very nice combination. It does not force Comverse customers to move away from some of the billing engines and rating engines that they like.

That allows a gradual transformation to those that want to take this path. Obviously, people want to transform to CES. We encourage it, as well. But we see different angles of positive momentum with the digital component, with going to managed services which is quite rare for -- in the past have been at least with Comverse customers, and the acceptance in many other areas.

On top of all that we have additional services that Comverse did not offer before. So we more or less see that the engines that we anticipated while carrying this deal start warming up and performing, and we hope for continuation of that.

Amit Singh - *Jefferies - Analyst*

All right, great.

And then between last quarter and this quarter, now you are expecting your revenue growth to be slightly below the midpoint of your guidance range? I just wanted to get a sense of what changed there. And also it seems like a lot of AT&T revenue growth is sort of -- there's a bit of backend loaded acceleration in your guidance. I just wanted to test your confidence level in that.

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

It is mainly a matter of timing. We are basically trying to tell you that we are not losing the project we plan, we are not the deteriorating on pricing significantly. The regular pressure is always there, but when you take into account the overall market conditions, and you look at our competitors, and a lot of not so good things happening around us, we cannot exclude that there will be some slowdown in certain areas of ours.

And when we contemplate forward on a detailed level from bottom up, all the different accounts, the timing of projects, and so on and so forth, we came to the conclusion that the third and mainly fourth quarter will be -- again, will grow faster than the beginning of the year. It's just that the overall will be slightly lower than the midpoint. I would say probably it's 30, 40, 50 basis points, maybe half a percentage. So it's not like significant, but it's a result of when you add up all the timing and execution of projects, that's what you will end up.

I think in terms of our position or momentum in the market, and many other indications including Comverse and the new project in Domain 2.0, which is a network function authorization project. And the wakeup that we see in the cable and satellite industry shows that the fundamentals -- that we believe the fundamentals are as good as always. It's just when we add up all the numbers and some of the slowdown of project conversion from sales to project, or decision to project, we are guiding to slightly over midpoint on mainly the Quarter Four.

Operator

(Operator Instructions)

Ashwin Shirvaikar, Citi.

Ashwin Shirvaikar - *Citi - Analyst*

Thanks. Hi. I got disconnected just as Tamar was saying, let's go to questions.

Congratulations on the quarter. I like the capital allocation announcement. It is good to hear the win at AT&T. Two subparts: do the wins affect the pricing on the overall contract, and secondly, on their earnings call AT&T also had comments on service delivery authorization and IT rationalization. How does that affect you?

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

So pricing in general is always an issue that we deal with. Our new deal with AT&T does not connect to pricing. We are competitive; everybody knows AT&T, so it's not like we are the only people that know AT&T. So we have to be competitive on everything we do there. Definitely on everything new that we do, and this new activity is on the network function visualization is a fruition of a very long process.

AT&T does not take any discounts, or nothing less than perfect, so they obviously compared us with everybody and his wife -- everybody. Everybody wants to be part of this project. And the fact that we are the lead partner to develop together with AT&T these components of the Domain 2.0 is definitely encouraging and exciting, and it's a groundbreaking product set. Whether we will be able to sell it later on in many copies or whatever, I don't know yet. It is way too early. We're just constructing as we speak.

But pricing was not part of this thing. It was pure engineering capability, no discount, no shortcuts type process that took more than a year. And you can imagine that all the big names, like biggest names in the industry, were competing for that, and we won it and we are very pleased with it.

In terms of the other comment about IT authorization and many things like this, we are working with AT&T as a very close partner for many years, especially in the last few years in many new areas. I'm sure that they are focusing with high-level of attention to DIRECTV and the transformation that they need to go through there.

They did not do this acquisition for $67 billion or so for leaving IT intact. We are talking about things they are doing on the wireless spec --wireless, I mean Cricket, everything. And some of this -- some of it I hope it will be with us in the future. We want to win as much as we can, but we bring a lot of value to AT&T, I believe. And we are working very diligently to try to convince AT&T, such as in the innovative Domain 2.0, that even on new projects we are the most trustworthy, capable partner that they can choose. So the most important thing in my opinion in their announcement is that they have activity.

They want to address it, they want to tackle it heads on. AT&T does not leave things unattached, or just sitting on the hand. That's not AT&T. So the rest of it, the details will have to wait until we get there.

Ashwin Shirvaikar - *Citi - Analyst*

Thank you for those comments. To follow up on the note, very good managed services traction that you are seeing, particularly nowadays outside the US.

And the question I have is if you can comment on the impact on the business model, does it become more stable in terms of outcomes because of this [worst] impact on profitability. Do you need to build in country facilities in each of these countries to support managed services, or can you do with just regional or global facilities?

Tamar Rapaport-Dagim - *Amdocs Ltd - CFO*

Thank you, Ashwin. I think it is a very important point. We always said that it is part of the buildup of relationship with customers. We see that as a long-term cycle. Usually it starts with the transformation project, and we would like them to see that evolving into additional capabilities we can provide. Managed services is definitely an important one among that list, as well as app sell of additional products.

And with managed services I'm happy to see the phenomena you described, that we are seeing also outside North America in recent years customers moving into managed services. Sometimes it's a customer that's already implemented our product and went into production and then moving into managed services.

And sometimes like in case of the recently announced deal with the Three in Ireland it's assigned what's called managed transformation that includes some of the [possession] project, as well as taking responsibility for the legacy. They want to manage services and then put the new system that will be put in place.

In general, the delivery model we have is comprised of large global sensors of competencies in different aspects, as well as some relatively thin layer, usually on the ground. We have been practicing that for years, including automated tools around that, and different sophisticated capabilities to build in terms of how to do it in an effective way.

And in terms of the business impact, we definitely like the recurring nature of the revenue that comes with the managed services, and not less important is the fact we are becoming incumbent within the customer on a day-to-day basis. We stay very close to what's happening within the customer environment, can identify different pain points, can bring to the table different ideas and proactively suggest additional things we can do for the customers.

So it is creating a different type of relationship beyond just the contractual revenue that is coming in with that repeated activity. From margins point of view, it's comparable to the average corporate margins. Usually in a managed services deal or specific deal, there is some pressure in the beginning as we put the set up cost in place and build the capabilities, and then it's expanding over time. But given the fact that it is a portfolio of many deals across the Company, we do see that is actually something that can definitely help in building the scale and the capabilities.

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

I just want to add that we are expanding the operation capability as we go. In the last three years we opened operation centers in Manila for Southeast Asia. We are expanding our activities in Mexico in Guadalajara. We have operations center in Nazareth, and we developed software that allow us to control trouble ticketing, monitoring, preventive managed services globally so we can move the traffic based on where we have people availability and when we have expertise. So this entire machine is becoming more scalable and more effective as we are adding more customers into this environment. All together it is usually a good thing for us.

Operator

(Operator Instructions)

That concludes our question and answer session for today. I would like to turn the conference back over to Matthew Smith for any closing comments.

Matthew Smith - *Amdocs Ltd - Head of IR*

Thank you very much for joining our call this evening, and for your continued interest in Amdocs. We look forward to hearing from you in the coming days. And if you do have any additional questions, please call the Investor Relations group. Have a great evening, and with that we'll conclude the call.

Eli Gelman - *Amdocs Ltd - President & CEO of Amdocs Management Limited*

Thank you.

Operator

Thank you. Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may now disconnect. Everyone have a good day.
