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Q2 2022 Amdocs Ltd Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Q2 2022 Amdocs Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your first speaker today, Matthew Smith, Head of Investor Relations. Sir, you may begin.

Matthew E. Smith ***Amdocs Limited - Secretary & Head of IR***

Thank you, operator. Before we begin, I need to call your attention to our disclaimer statement on Slide 2 of the presentation. It notes that some of our comments today may be forward-looking statements and are subject to risks and uncertainties as described in Amdocs' SEC filings and that we will discuss certain financial information that is not prepared in accordance with GAAP. 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.

Participating on the call with me today are Shuky Sheffer, President and Chief Executive Officer of Amdocs Management Limited; and Tamar Rapaport-Dagim, Joint Chief Financial and Operating Officer.

To support today's earnings call, we are providing a presentation, which can be found on the Investor Relations section of our website. And as always, a copy of today's prepared remarks will also be posted immediately following the conclusion of this call.

On today's agenda, Shuky will recap our business and financial achievements for the second quarter of fiscal 2022, and we'll update you on the continued progress we have made executing against our strategic growth framework. Shuky will finish by commenting on our financial outlook, after which Tamar will provide additional details on our second quarter financial performance and guidance.

As a reminder, our comments today will refer to certain financial metrics on a pro forma basis where applicable, to provide you with a sense of the underlying business trends, excluding the financial impact of open market, which we divested on December 31, 2020.

And with that, I'll turn it over to Shuky.

Joshua Sheffer ***Amdocs Limited - President, CEO & Director***

Thanks, Matt, and good afternoon to everyone joining us on the call today.

I'd like to begin on Slide 6 with a huge thank you to our thousands of employees worldwide. Following a great Q1, our second quarter was also very strong, and I could not be more pleased with our operational and financial execution for the fiscal year-to-date.

Last quarter, we provided the guidance for the annual constant currency revenue growth of between 6% to 10% over the next 3 fiscal years. And on the strength of our recent performance, I can already say that we are tracking at the high end of this range on a pro forma basis for the current fiscal year-to-date.

I believe such great performance is a testament to our market leadership and the successful education of our highly relevant growth strategy, the credit of which belongs to our global and diverse base of incredibly talented employees across all dimensions of our business. I could not be proud of Amdocs' people, and I'm highly confident that we are well positioned for future success.

Now moving to Slide 7, let me address our second quarter operational highlights. To begin, overall, business activity was very strong as we continue to enable our customer strategy to provide a superior customer experience by supporting the highly necessary investment in 5G and product monetization, cloud adoption, digital modernization and network automation.

Activity was particularly high in North America, where Amdocs is in the heart of the major strategic long-term investment occurring at our large and long-standing customers. For instance, we continue to support the multiyear modernization of AT&T consumer domain, which is the core to its strategic focus on 5G and fiber connectivity.

We are also glad to be core part of T-Mobile's modernization journey, where we are implementing our next-generation products and cloud services that will support T-Mobile's long-term competitive position, and the realization of the synergies related to the Sprint integration.

We also maintained robust sales momentum in Q2. We extended our long-standing managed services relationship with Bell Canada for another 5 years, as we continue to support its cloud transformation. We won a digital information project with VodafoneZiggo in Netherlands and a new 5G policy deal with a Tier 1 European operator, which expands our existing footprint at this customer.

Additionally, we strengthened our partnership with PLDT in the Philippines with a 3-year extension of our existing managed services agreement in addition to future projects to support PLDT's cloud journey. I was especially pleased we have superb execution in Q2. As we set another record for a number of project milestone deployed.

Among our achievements, we completed a major digital transformation program for Three UK's enterprise customer segments, where we moved from scoping, to building the cloud infrastructure, and go live in just 15 months. Such accomplishments reinforced our unrivaled reputation for project delivery and strengthened our ability to maintain a high win rate in the market.

As a final highlight, we further accelerated our R&D investment this quarter, underscoring our commitment to continuously bring cutting-edge technology and world-class product and platforms to market. At Mobile World Congress in Barcelona this quarter, we launched CES22, our latest open and modular cloud-native 5G suite.

After the 2-year pandemic, it was exciting to experience the positive customer energy at this year's show, and I was highly encouraged by the strong feedback we received in respect to our offering in strategic direction throughout a dozen of C11 executive meetings we hosted during the week.

Great operational performance translates into very strong second quarter results, the highlights of which can be seen on Slide 8. Record revenue of $1.15 billion marked a third straight quarter in which pro forma growth was exceeding 10% year-over-year on a constant currency basis. We also achieved record 12 months backlog of $3.89 billion, up 10% from a year ago, and driven by the robust sales momentum, I highlighted earlier.

On the bottom line, we delivered a non-GAAP earnings per share of $1.54, which was above the high end of guidance, mainly due to a lower-than-anticipated non-GAAP effective tax rate for the quarter.

Turning to Slide 9. Let me say a few words about Amdocs' exposure to Russia and Ukraine and our response to the humanitarian crisis unfolding. From a business perspective, Amdocs' exposure to Russia and Ukraine is immaterial and roughly 1% of revenue, and its impact is already reflected in our guidance. Furthermore, we believe we have taken all necessary steps to ensure we are fully compliant with the applicable sanctions and export control, and we have stopped all new sales of our product and services in Russia.

We have also taken steps to ensure the wellbeing of the employees and contractors we have in the region and to support those who wanted to leave with their families. Additionally, we are actively providing humanitarian aid in Ukraine and neighboring countries. Among our many initiatives, Amdocs is part of a donation campaign to provide essential services via UNICEF to vulnerable children and affected families. We are also offering financial support to Amdocs' employees, who are hosting refugee families.

Now let's take a closer look at our recent progress executing against our 4-pillar growth strategy of cloud, 5G, digital and network automation is shown on Slides 10 and 11.

Beginning with Cloud Services. T-Mobile has recently implemented Amdocs' business assurance solution on AWS, leveraging cloud and artificial intelligence, this implementation will help to drive margin synergies with Sprint by accelerating the migration to combined customer base and is part of the larger digital transformation and extended hybrid cloud operation, we are supporting for T-Mobile under the multiyear managed services agreement we announced last year.

Additionally, we are proud to say that we recently extended our long-term standing relationship with Bell Canada as part of a new 5-year managed services engagement, to enrich its business platform with real-time agile and cloud-ready ecosystem, as part of its continued cloud transformation.

Switching to 5G monetization, we are excited to announce a 5-year deal with a Tier 1 European operator, which will implement Amdocs' policy control solution on cloud infrastructure to support its new 5G stand-alone network. 5G stand-alone network will be central to unleashing the full potential of 5G and Amdocs' policy control solution is a key element that will enable this customer to launch cutting-edge 5G services and business model for its residential and business customers, while reducing operational costs.

Within digital, we expanded our long-term standing relationship with VodafoneZiggo in the Netherlands, which has selected Amdocs' product and services for a wide-ranging digital transformation projects. Amdocs will migrate fixed line customer to a platform previously built by Amdocs for VodafoneZiggo's mobile customers, thereby resulting in a unified customer journey, shorter average handling times, reduced time to market, and cost savings linked to the retirement of its old fixed-line IT stack.

Q2 was also a productive quarter in network automation. Among the customer highlights, we are delighted to announce that we have continued to expand our relationship with Comcast, which has selected Amdocs for a multiyear network automation testing deal.

In Europe, we signed a first-ever agreement with Vodafone Albania, which expanded previously announced deal to provide inventory next-generation OSS capabilities for Vodafone's Mobile fits and cable offering in Germany, Romania and Czech Republic.

We also successfully completed a network inventory modernization project with Fastweb, which will enable the Italian service provider to improve time to market with innovative new services in the 5G and cloud area.

As a final comment, let me mention Amdocs Media, which has been selected to deploy our Amdocs MarketONE SaaS platform on the public cloud for Virgin Media O2. MarketONE will give consumers the ability to add entertainment subscription to their monthly bill or enjoy them as part of a bigger bundle with their existing broadband, mobile and cable packages.

Additionally, Virgin Media O2 will be able to easily expand its growing portfolio of new OTT partners, as its look to further improve customer loyalty. Overall, this exciting project provides another sign of positive customer traction for MarketONE, which has already been selected by T-Mobile, AT&T Mexico and others.

Now turning to our financial outlook on Slide 12. As I said at the beginning of my remarks, I could not be more pleased with our Q2 performance. Our sales momentum is strong, and we see a large and expanding pipeline of opportunities ahead of us, which we expected to monetize by leveraging our innovative market unique technology, our unrivaled track record of execution, and our highly skilled intelligent employee base, which is focused on delivering value to our customers worldwide.

Wrapping everything together, we are confident that Amdocs can deliver annual revenue growth within the range of 6% to 10% on a constant currency basis over the 3 fiscal years 2022 to 2024. And as a company, we have entered a new area of accelerative growth.

Regarding fiscal year 2022 specifically, we are now tracking at the high end of our revenue growth guidance range of 8% to 10% on a pro forma constant currency basis. Similarly, we are also tracking at the high end of our diluted non-GAAP earnings per share growth guidance range of 9% to 12% on a pro forma basis in fiscal year 2022, which fairly position us to deliver double-digit, expected total shareholder return for the second year running, including our dividend yield of roughly 2%.

With that, let me turn the call to Tamar for her remarks.

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & COO***

Thank you, Shuky, and hello, everyone. Thank you for joining us. As a reminder, my comments today will refer to certain financial metrics on a pro forma basis, which exclude the financial impact of OpenMarket, which we divested on December 31, 2020.

Turning to our financial highlights on Slide 14. I'm very happy with our exceptional performance in the second fiscal quarter, which followed an already strong start to the year. Record Q2 revenue of $1.15 billion was up 10.1% year-over-year, driven by our best-ever quarter in North America and sequential growth in Europe and rest of the world. Revenue was in line with the high end of guidance, including an immaterial impact from foreign currency movements compared to our guidance assumptions.

Moving down the income statement. Our Q2 non-GAAP operating margin of 17.6% was up 10 basis points sequentially, and unchanged as compared with a year ago, as accelerated R&D investments and the effect of the competitive labor environment were more than offset by our relentless focus on operational excellence, including the ongoing implementation of automation and other sophisticated tools, designed to continuously improve efficiency.

On the bottom line, non-GAAP diluted EPS of $1.54 was above the high end of our guidance range. Diluted non-GAAP EPS includes a non-GAAP effective tax rate of 1.6%, which was much lower than we anticipated for the quarter, primarily due to release of tax reserves connected with funding decisions for the construction of our new campus in Israel.

This tax benefit was among the scenarios contemplated in our non-GAAP effective tax rate guidance for the full fiscal year 2022, which is still anticipated to be within a range of 13% to 17%. Diluted GAAP EPS was $1.28 for the second fiscal quarter, which was also above the guidance range of $0.96 to $1.04, primarily due to the lower effective tax rate we anticipated for the -- than we anticipated for the quarter.

Moving to Slide 15. Robust sales momentum during the second quarter translated to record high 12 months backlog of $3.89 billion, which was up 10% from a year ago. On a sequential basis, 12 months backlog was up $60 million as compared to December 31. As a reminder, our 12 months backlog includes anticipated revenue related to contracts, estimated revenue for managed services contracts, letters of intent, maintenance, and estimated ongoing support activities.

To further clarify, a new deal with the customer will only be included in 12 months backlog once contract is duly signed. Given the overall nature of the work included, our 12-month backlog has traditionally served as a good leading indicator of our business, having consistently averaged around 80% of forward-looking 12 months revenue over the years.

Turning to Slide 16. Q2 was also a record high quarter for revenue from managed services engagements, which grew 5% from a year ago, equating to roughly 58% of total revenue. Our multiyear managed services engagements underpin the resiliency of our business with recurring revenue streams, close to 100% renewal rates, and expanded activities, which may also include large-scale digital transformation project with existing customers. For instance, we recently extended our managed services relationship with Bell Canada for another 5 years through 2027, as we continue to support its cloud transformation.

Additionally, we strengthened our partnership with PLDT in the Philippines, where this leading operator has awarded Amdocs a 3-year extension of our existing managed services agreement through 2028, in addition to future projects to support PLDT's cloud journey.

Turning to the balance sheet and cash flow. As you can see on Slide 17, DSO of 81 days increased by 2 days year-over-year and 2 days sequentially in Q2, primarily reflecting higher invoicing levels triggered by a record number of milestone deliveries achieved in the quarter.

Additionally, the net positive difference of deferred revenue nonbilled receivables further improved in Q2. Altogether, we generated normalized free cash flow of $160 million. This was a strong performance considering that Amdocs' free cash flow tends to be seasonally weaker in our second fiscal quarter due to the timing of annual bonus payments.

We believe we are well on track to achieving our target of $650 million for the full fiscal year 2022. Overall, we ended the quarter with a strong cash balance of approximately $856 million, including aggregate borrowings of roughly $650 million. Our balance sheet remains strong, and with ample liquidity, we expect to be in a good position to continue to support our ongoing business needs, while retaining the capacity to fund our future strategic growth investments as and when the right opportunities arise.

Turning to capital allocation on Slide 18. As you can see in the first chart, we repurchased $130 million of our shares in the second quarter. Including cash dividend payments of $44 million, we returned $174 million to shareholders in Q2, equating to more than 100% of normalized free cash flow.

We expect to return a majority of our normalized free cash flow to shareholders for the full fiscal year 2022. As an added point, our normalized free cash flow outlook of $650 million assumes a conversion rate of roughly 100% of non-GAAP net income, which is consistent with our long-term average.

Normalized free cash flow excludes anticipated CapEx of about $131 million in relation to the development of our new Israeli campus, consistent with our previous expectation.

Now turning to our outlook on Slide 19. The prevailing level of macroeconomic business and operational uncertainty remains elevated, including with respect to the magnitude and duration of the COVID-19 pandemic. The third quarter and full fiscal year 2022 revenue guidance reflects what we consider to be the most likely outcome best of the information we have today, but we cannot predict all possible scenarios.

With that said, we are tracking in line with the high end of our full year fiscal 2022 revenue growth guidance of 8% to 10% on a pro forma constant currency basis, which includes positive contributions from each of our 3 operating regions of North America, Europe and Rest of the world.

Our annual outlook includes third fiscal quarter revenue within a range of $1.14 billion to $1.18 billion, the midpoint of which represents the most likely outcome based on our internal analysis, equating to healthy growth of roughly 9% as reported from a year ago.

On a reported basis, full year revenue growth is also tracking in line with the high end of our guidance range of 5.2% to 7.2% year-over-year. Our reported revenue outlook anticipates an unfavorable foreign currency impact of approximately 80 basis points year-over-year as compared with our previous expectation of 60 basis points.

Moving down the income statement, we anticipate non-GAAP operating margin to track roughly in line with the midpoint of our annual target range of 17.2% to 17.8% in the first -- in the third fiscal quarter and the fourth quarter. This outlook continues to assume an accelerated pace of R&D investment to support our customers in line with our strategy, balanced with our constant focus on operational excellence, as mentioned earlier.

Below the operating line, we anticipate that foreign currency fluctuations will continue to impact our non-GAAP net interest and other expense lines in the range of a few million dollars on a quarterly basis.

We expect that non-GAAP effective tax rate in the third and fourth fiscal quarters will be above the high end of our annual target range of 13% to 17%. For the full fiscal year 2022, we expect our non-GAAP effective tax rate to be within this annual target range of 13% to 17%.

Bringing everything together, we expect to deliver pro forma non-GAAP diluted earnings per share growth in line with the high end of our guidance range of 9% to 12% for the full fiscal year 2022. On a reported basis, we also expect non-GAAP diluted earnings per share growth in line with the high end of our guidance range of 7.3% to 10.3% year-over-year.

Overall, we are fairly on track to deliver double-digit total shareholders' return for the second fiscal year running in 2022, assuming the higher end of our pro forma non-GAAP earnings per share growth guidance plus our dividend yield.

With that, back to you, Shuky.

Joshua Sheffer ***Amdocs Limited - President, CEO & Director***

Thanks, Tamar. Well, as you can probably tell from our remarks today, we are excited by our first half performance, our recent strategic progress and the strong outlook we have provided for the first fiscal year.

With that, we are happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question will come from Ashwin Shirvaikar with Citi.

Ashwin Vassant Shirvaikar ***Citigroup Inc., Research Division - MD & Lead Analyst***

Congratulations on the solid quarter here. So maybe I can ask both my questions together. The first one is just given the trends in the solid backlog, is it reasonable to assume this sort of growth rate could continue into fiscal '23? And to be sure, this is a directional question, I'm obviously not looking for 2023 guidance.

And then the second question partially related is Bell Canada renewal. Is there any like price discounting or revenue margin impact -- revenue or margin impact that we should worry about? Or are you just absorbing this kind of impact?

Joshua Sheffer ***Amdocs Limited - President, CEO & Director***

Let me start with the second question for Bell Canada. I think we discussed it before. We never renew an agreement as what we call an apples-to-apples. So the new agreement is a comprehensive agreement, both for managed services and both for cloud transformation. We are very happy with this agreement and does not imply any pressure on our numbers.

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & COO***

Regarding the looking forward and how we should read into the 12 months backlog as a leading indicator, so by definition, it's a 12-month backlog, meaning it covers half 2 of the current fiscal year and the first half of the next fiscal year. And definitely, the fact we are tracking already for several quarters at the neighborhood of the 10% year-over-year growth of the backlog is showing the great conversion and momentum we are seeing in signing new business in continuing to see this 100% renewal rate in managed services, everything that we talked about, which gives us strong confidence.

As you said, it's a bit too early to guide for 2023, but the momentum is there. The pipeline is strong. The fact we're seeing this growth in all the key 3 regions is very encouraging. As I said already in the prior quarter, Europe is expected to accelerate in the second half of the year. By the way, most of the currency impact we are talking about on the company level is impacting our Europe numbers. So we believe that on a constant currency basis, Europe is already growing and is going to accelerate in the second half of the year.

And also the momentum we are continuing to see in terms of the relevance of the offering we bring to market, to the growth strategic pillars and the investment areas of our customers. As we said before, we continue to see all indications that those investment areas are multiyear investment domains, so not only the programs we are running are already secured for many of these cases for many years, also the investment plans we are seeing by dialogue with our customers.

Operator

Your next question will come from Will Power with Baird.

Charles Joseph Erlikh ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

This is Charlie Erlikh on for Will. Tamar, I'm just looking at the third quarter guidance and the full year guidance. And I think if my math is right, it implies that Q4 revenue was down sequentially a bit from Q3. Am I doing my math right? Is that correct? And if so, what would be the cause of that?

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & COO***

No, it's not correct. And this is why we -- look, talking about midpoint, it's not correct. Obviously, the reason we are giving both the range, but also targeting and saying very clearly, we believe the most likely scenario is that we end the year at the high end of the range of 8% to 10%. We need to give a range in order to take care of different scenarios that may play out, but we are confident in the outlook that we're giving. And no, I don't think we should see a sequential decline.

Charles Joseph Erlikh ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

Okay. No, that's helpful.

Joshua Sheffer ***Amdocs Limited - President, CEO & Director***

The short answer is no.

Charles Joseph Erlikh ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Associate***

Yes. And then on the R&D investments that you talked about; can you just talk a little bit more about what those investments are going towards?

Joshua Sheffer ***Amdocs Limited - President, CEO & Director***

I mean, obviously, given our position, we see a lot of opportunity to continue to enhance our products to support all the new use cases that will exist and are developing right now, both for consumer and B2B. So it's in the network domain, in our monetization platform, it's across the board. And we always try as much as we can to be ahead of the market, developing our products to be ready to take it to market. So it's mainly in the same pillars, but getting to the next level of capabilities.

Operator

(Operator Instructions) And I'm showing no further questions at this time. I will now hand it back over to Matthew Smith for closing remarks.

Matthew E. Smith ***Amdocs Limited - Secretary & Head of IR***

Thank you very much, everybody, for joining the call this evening. And if you do have any further questions, please contact us here in the Investor Relations group. With that, have a great night. Thanks.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.