THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2018 Amdocs Ltd Earnings Call

EVENT DATE/TIME: JULY 31, 2018 / 9:00PM GMT

CORPORATE PARTICIPANTS

Eli Gelman *Amdocs Management Limited - Director, CEO and President*
Matthew E. Smith *Amdocs Limited - Secretary*
Tamar Rapaport-Dagim *Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd*

CONFERENCE CALL PARTICIPANTS

Ashwin Vassant Shirvaikar *Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst*
Jackson Edmund Ader *JP Morgan Chase & Co, Research Division - Analyst*
Thomas Michael Roderick *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q3 2018 Amdocs Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded for replay purposes.

It is now my pleasure to hand the conference over to Mr. Matt Smith, Head of Investor Relations. Sir, you may begin.

Matthew E. Smith ***Amdocs Limited - Secretary***

Thank you, Brian. 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 the 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 risks include, but are not 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, 2017, filed on December 11, 2017, and our Form 6-K furnished with the first quarter of fiscal 2018 on February 12, 2018, and the second quarter on May 21, 2018. 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 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 Management Limited - Director, CEO and President***

Thank you, Matt, and good afternoon to everyone joining us on the call today. We are pleased with our solid third quarter performance, which was notable on several fronts. Revenue exceeded the $1 billion mark for the first time and was in line with the midpoint of our guidance adjusting for currency. We maintained a high win rate across our various business lines and operating regions, and we made positive progress integrating our recent acquisitions of Vubiquity and UXP Systems within the broader Amdocs.

This quarter, I'm also pleased to report some exciting developments with respect to our strategic initiatives in Network Function Virtualization and media and entertainment. I will provide an update on these important growth engines later in the call. But first, let me offer some color in regarding to our regional businesses activities in quarter 3.

Beginning with North America. Revenue grew on a sequential basis as we supported the digital modernization and integrate carrier strategies of a broad-based of wireless and pay-TV customers. Regarding the business environment in North America, service providers continue to face fierce competition, resulting from the convergence of wireless and pay-TV offerings with content ownership and direct-to-consumer business models. As a result of these rapidly changing market dynamics, we see many opportunities to support the strategic requirements of our customers in North America, which we believe will translate to positive long-term growth trajectory in the region.

That said, we remind you have of the many moving parts that's affecting our North American outlook, and we expect sequential trends to fluctuate in the foreseeable future further before growth resumes in a steadier way. As a reminder, industry consolidation activity continues to present an additional source of uncertainty in our outlook, including T-Mobile planned merger with Sprint or others, which may be contemplated in the future.

Moving to Europe. We delivered our fourth consecutive quarters of year-over-year growth in spite of foreign currency movement, which negatively impacted our sequential performance. Along with these highlights of the quarter, we were pleased to be selected to support the launch of Sky Italia, a new telco offering under a multiyear managed services agreement that includes delivery of Amdocs open network or accessory on a cloud-enabled platform.

As we are in the region, we were selected as a technology partner for MTS, the leading telecommunication group in Russia and the Commonwealth of Independent States, CIS, where we are part of the project that will enable MTS to achieve greater level of self-service, a reduction in manual processes and simpler onboarding of new partners in emerging areas, such as IoT.

Regarding the outlook in Europe, we are on track to grow faster than the corporate average in fiscal 2018. Although we remind you that sequential trends could fluctuate due to factors such as foreign currency movements and the project orientation of our customer engagement in the region.

Turning to the rest of the world. Growth continued at a solid pace in quarter 3. During the quarter, we deployed and automated an intelligent operation capability for Vodafone India. We also partnered with Telstra in Australia to implement a next generation OSS platform for its B2B line of businesses that will enable Telstra network domain to evolve towards virtualization, while maintaining the impact of its existing support system. Additionally, we recently partnered with Amazon Web Service to deliver cloud-based omnichannel routing and interaction management for Globe Telecom in the Philippines. This is our first award in collaboration with AWS, and is notable because it demonstrates that we have deep domain expertise necessary to move communication in media companies into the cloud environment. Overall, our business in Rest of the World is on track to grow on a constant currency basis in fiscal 2018, mainly led by Asia and the surrounding pacific regions, where activity continue to be stronger compared to Latin America. As a reminder, quarterly trends may fluctuate in the Rest of the World, primarily due to the project orientation of our customer engagements.

To summarize my insight on a regional basis, we are pleased with our execution for the year-to-date. With only the fourth quarter remaining, we have enough data points to indicate that our revenue from AT&T will probably decline in a double-digit rate in fiscal 2018. And yet, we still expect to meet our total revenue targets for the full year as a result of a strong progress that we have made in new and existing customers in the broader North America, in Europe and in Rest of the World. We believe that this performance is a testament to our unique business model, our focus on execution and the innovation we're bringing to customers. This trend has been especially evident during the period of rapid market changes we have seen in the last few years, including that resulting from the AT&T acquisition of Time Warner, which we consider to be a singular industry event of size and magnitude that is unlikely to repeat in the foreseeable future.

Now let me update you on regarding some positive and exciting developments in the following strategic areas. Network Functions Virtualization, or NFV, and media and entertainment. Beginning with NFV. We are today excited to announce that Amdocs is supporting the commercial availability of Comcast, software-defined wide area networks, SD-WAN, service for the enterprise businesses. The SD-WAN offering leverages Amdocs' leading NFV portfolio, which brings orchestration, fulfillment and automation capabilities to service providers while integrating a wide array of virtualized service functions from their vibrant and diverse partner ecosystem. Moreover, this is an important milestone. It comes a year after the first time we told you that we are supporting Comcast to better help drive in SD-WAN, and it serves to illustrate how small initial engagement may ultimately lead to a delivery of significant value to our customers.

Along these lines, we are also encouraged to have recently seen some pickup in the number of global service provider that are beginning to evaluate NFV, and we are working hard to demonstrate to them that we should be the partner of choice to support their future plans.

Turning to the media and entertainment. The post-merger integration of Vubiquity and UXP are going according to plan, and we are encouraged to have already seen an expansion in the pipeline of opportunities relative to when we close these transactions earlier this year. Along these lines, we are today pleased to announce that Verizon has selected Vubiquity's managed services and technology platform to provide the processing and packaging of Verizon's vast video on-demand and pay-TV Pay Per View portfolio across the Fios multiscreen platform. This deal represents the expansion and extension of Vubiquity's existing relationships with Verizon and demonstrates that we are well positioned to capitalize on the convergence of traditional service providers with content owners, OTT web players and the direct content to consumer business model.

To wrap up, we believe the long-term market dynamics I have outlined today leave Amdocs well positioned for continued growth. Further details of reach will be provided in November. In the meantime, we entered quarter 4 with record 12 months backlog, and we are on track to deliver non-GAAP EPS growth in the mid to high-single digits for the seventh consecutive year in fiscal 2018.

On a personal note, the Board of Directors have today accepted my plan to retire as CEO at the end of the fiscal year 2018. I feel very confident in the company's position and long-term outlook. And I believe now is the right moment for me to hand over the rein to my long-time colleague and friend, Shuky Sheffer, who I am pleased to announce will resume the position of President and Chief Executive Officer of Amdocs effective October 1, 2018.

After 31 years with Amdocs, including 8 years as a CEO, I believe this is a natural and timely move, which is well aligned with Amdocs net maturity and future strategic direction. I have every confidence this transaction will be a smooth one. Shuky is a veteran of Amdocs, who may be a familiar face to those of you who have attended our annual Analyst and Investor Days over the years. I have no doubt that his deep understanding of Amdocs and our market will serve our employees, our customers and our shareholders well going forward. And I believe the board has selected a strong leader, whose previous experience also includes being a CEO of another listed company.

Just as important, I have every confidence that Shuky will have the support of a deep bench of Amdocs veterans, who each day provide the strong leadership, which is required across many areas of the company. One of the many examples is our current CFO, Tamar Rapaport-Dagim, who I'm delighted to say will be expanding her role to include that of Chief Operating Officer, where she will be responsible for ensuring the company's continued reputation for operational excellence. I am pleased to have Shuky with us in the room today, and he will be available to take some Q&A later in the call. As for myself, I have gladly agreed to stay on the Board, where I still hope to make meaningful contribution to the company and its shareholders in the years to come.

With that, I will turn the call over to Tamar.

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd***

Thank you, Eli. Third fiscal quarter revenue of $1 billion was at the midpoint of our guidance range on a constant currency basis after adjusting for a $9 million negative impact from foreign currency movements relative to guidance. Our third quarter guidance range has included a minimum of sequential impact from foreign currency fluctuations. Our third fiscal quarter non-GAAP operating margin was 17.3%, unchanged from a year ago, and in line with the higher end of our long-term target range of 16.5% to 17.5%. Below the operating line, non-GAAP net interest and other expense was $3.2 million in Q3, primarily reflecting foreign exchange movements.

For forward-looking purposes, we continue to expect a non-GAAP net interest and other expense in the range of a few million dollars quarterly due to foreign currency fluctuations.

Diluted non-GAAP EPS was $1.03 in Q3, in line with the midpoint of our guidance range of $1 to $1.06. As we anticipated, our non-GAAP effective tax rate of 13.4% in Q3 was near the low end of our expected annual range of 13% to 17%. Diluted GAAP EPS was $0.64 for the third fiscal quarter, below our guidance range of $0.71 to $0.81, due to nonrecurring restructuring charges, primarily associated with recently completed acquisitions and internal business realignment actions in North America, net of tax effects.

Free cash flow was $128 million in Q3. This was comprised of cash flow from operations of approximately $164 million, less $36 million in net capital expenditures and other. Capital expenditure relating to the multiyear development of our new campus in Israel was immaterial this quarter. DSO of 89 days was flat quarter-over-quarter. We remind you that this item may fluctuate from quarter-to-quarter.

Total unbilled receivables decreased by $4 million as compared to second fiscal quarter of 2018. Our total deferred revenue, both short term and long term, increased by $11 million sequentially in Q3. The net balance of unbilled receivables and total deferred revenue reflects our high level of transformation project activity and resulting timing differences between revenue recognition and the invoicing of customers.

Our 12-month backlog, which includes anticipated revenue related to contracts, estimated revenue for Managed Services contracts, letters of intent, maintenance and estimated ongoing support activities was $3.33 billion at the end of third fiscal quarter, up $10 million sequentially from the end of the prior quarter. Our cash balance at the end of the third fiscal quarter was approximately $561 million.

During the third fiscal quarter, we repurchased $90 million of our ordinary shares. In total, we have, as of June 30, more than $725 million of authorized capacity for share repurchases to be executed at the company's discretion going forward with no stated expiration date. As a reminder, we retain the flexibility to vary the level of share repurchase activity from quarter-to-quarter depending on factors, such as the outlook for M&A, financial markets and prevailing industry conditions.

Now turning to our outlook. We expect revenue to be within the range of $980 million the $1.02 billion for the fourth fiscal quarter of 2018. Embedded within this guidance is a negative sequential impact of approximately $5 million from foreign currency fluctuations as compared to Q3. For the full fiscal year 2018, we now expect total revenue growth in the range of 2.2% to 3.2% as reported compared with 2.3% to 4.3% previously. The midpoint of the new range is 50 basis points lower than the previous guidance due to currencies. We now expect positive impact from foreign currency fluctuations of approximately 0.5% year-over-year for the full year of fiscal 2018 compared with our prior expectation for a positive impact of about 1%.

On a constant currency basis, we expect total revenue growth in the range of 1.7% to 2.7% for the full fiscal year 2018 compared with 1.3% to 3.3% previously. Additionally, our fiscal 2018 revenue outlook continues to incorporate an expected drag of roughly 0.5% from directory, which we anticipate will continue to decline in the full year. We continue to expect our non-GAAP operating margins to be within a range of 16.5% to 17.5% in fiscal 2018, and we expect our non-GAAP operating margin to fluctuate at the higher end of this range in fiscal 2018. We expect the fourth fiscal quarter diluted non-GAAP EPS to be in the range of $0.95 to $1.01. With respect to Q4, we expect our non-GAAP effective tax rate to be above the high-end of our annual target range of 13% to 17%. For the full fiscal year, we still expect our non-GAAP effective tax rate to remain within the same target range of 13% to 17% for the full year.

Our fourth fiscal quarter non-GAAP EPS guidance also incorporates an expected average diluted share count of roughly 143 million shares and the likelihood of a negative impact from foreign exchange fluctuations in non-GAAP net interest and other expense.

For the full fiscal year, we expect full year diluted GAAP EPS growth of flat to negative 3% year-over-year compared to flat to positive 6% previously due to the nonrecurring restructuring charges recorded already in Q3. Additionally, we now expect diluted non-GAAP EPS growth of 5% to 7% year-over-year, which is narrowed around midpoint of our previous guidance of 4% to 8%.

With that, we can turn it back to the operator to begin our question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Tom Roderick with Stifel.

Thomas Michael Roderick ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

Congrats, Eli, on the pending retirement. That's great news, I'm sure, for you, although it brings some positive and a little bit of other news to the story. But congrats on that certainly. Looking at the business and some of the commentary you made around North America, could you maybe dig in a little bit on what you're seeing now at AT&T that a lot of the overhang from the Time Warner deals seemingly should be behind us and maybe what your discussions with AT&T have been around maybe where the projects and some of the things you're working on in the next couple of years are headed?

Eli Gelman ***Amdocs Management Limited - Director, CEO and President***

So Tom, obviously, I cannot give you a very detailed exposure to the dialogue we have constantly with AT&T at the highest level. I would give you a few data points. One is, first of all, it's not completely over, because the government decided to challenge AT&T. We actually don't believe personally -- the company, we don't believe that they will be able to do that. But it does represent a little bit of a slowdown in the execution plan if you expected AT&T media to rocket like a spring being released. It takes a little bit longer time. And to remind you, we don't have media numbers from AT&T specifically other than the businesses that we had originally with Vubiquity baked into the numbers. We believe this, by itself, will be over the next couple of years a growth engine, the timing of which we really cannot predict or share right now with you. And on other areas, which are indirectly affected, AT&T is a very big company and they see the growth engines including Cricket, including Mexico. They have a lot of business in the enterprise, which is new area for us, if we will be able to get in there. And I think they're also revisiting their strategy regarding mobility due to recent years of losing some market share. So altogether, we are seeing in AT&T activities in many, many, many, domains, obviously, from the network, NFV, 5G, first network and all that, all the way to Mexico and to other areas, including enterprise and in between. But other than that, it's really hard for me to give you more tangible data without compromising the AT&T information or without guiding really for specific estimate, which is something that we cannot do. It would not be useful for you and not be useful for us.

Thomas Michael Roderick ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

All right. Great. And then a lot of good wins that we saw some -- the press releases after the close today. Nothing specific on ONAP. But could you give us a little bit of an update in terms of how that's progressing? Are we moving towards being sort of a standardization across some of the larger carriers across the world? Or is it still a little bit in flux and you're still pressing forward with the opportunities that you have now?

Eli Gelman ***Amdocs Management Limited - Director, CEO and President***

So Tom, basically, if you read between the lines of the prepared remarks, we do see overall more opportunities and more initial phases. Unfortunately, all of them start very small. But fortunately, we have one more major carrier especially the early adopters because they are the people that make the decision now that see Amdocs as a major contribution to their journey into NFV. So I think that there's no question about the NFV. I think we have a better share than anyone else in cooperation with this companies. And we see an uptick -- uptake in the number of activities we have. The big news of today is Comcast. Comcast is something we started a year ago in one of the small, whatever, a couple of million dollars project, and that's became the backbone of SD-WAN. SD-WAN is basically the most popular enterprise service and enterprise is the growth engine of Comcast and many others. So to be the heart of the NFV domain for SD-WAN is a big deal. Regardless to -- also not only the numbers and the size of the project, it's the position. I believe once we finish this project, that includes the orchestration and activation and active inventory of this component, this is a base for additional services, so we are very bullish about it and you can hear it in our voice and likely we've also got at this time, which is quite rare, also the permission of Comcast to mention their name specifically. So we're thankful for that. So this is the big news of the quarter. But the Telstra deal of the OSS next-generation is also NFV-related. They are ONAP follower and few other proof-of-concept box that we are doing all around Europe and all around the world are also good indication that we are on the right track. As I said more than once, now we see more cases, but as I said more than once, the one thing, it's really hard for us to predict, and it's not like we really want to hold it back from you, is the pace of the additional projects. But every time we have these data points that I just shared with you, it makes us a little bit more optimistic about the NFV and the investment that we have made in this domain. So it is very exciting thing for us.

Thomas Michael Roderick ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD***

Great. Congrats, Shuky, Tamar, for the added the role and Eli on the retirement.

Operator

And our next question will come from the line of Jackson Ader with JPMorgan.

Jackson Edmund Ader ***JP Morgan Chase & Co, Research Division - Analyst***

Eli, the Vubiquity managed services contract with Verizon. Can you help us how we should be thinking about maybe a Vubiquity managed services contract versus the legacy Amdocs managed services contracts? How they're structured? How they're priced? Maybe term, that sort of thing.

Eli Gelman ***Amdocs Management Limited - Director, CEO and President***

Yes, it's slightly different, although there are some components that repeat itself. The idea is that instead of charging Verizon for every transaction on the S -- what is called SVOD and TVOD, which is the transactional video on-demand or subscription video on-demand, we kind of struck a deal with them that up to a certain level, it all will be included in like in a retainer or like in a fixed price, so to speak. So it is related to volume eventually, but we basically give them the whole service, packaging it in a certain commercial agreement and through a certain period of time. This specific line is actually including all the video on-demand and the Pay Per View of Verizon Fios, quite a significant contract. And it's a multiyear. I can't remember this -- Tamar, do you remember this, how long we signed it for this time?

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd***

I'm not sure we're at liberty to say, but several years...

Eli Gelman ***Amdocs Management Limited - Director, CEO and President***

Okay. But several years. So from this respect it's similar, but it has some different components. And again, it's something that is, I would not say customary, but it's something that Vubiquity did before, and we will may evolve this model later on with slightly different component. But we are very happy with this deal. It's a very important deal for us.

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd***

True.

Jackson Edmund Ader ***JP Morgan Chase & Co, Research Division - Analyst***

Okay. And then a quick follow-up. I think, Eli, you mentioned in your prepared remarks that Europe is expected to outgrow the broader corporate average. And I just want to clarify, is that after foreign exchange headwinds? Or is that on a constant currency basis?

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd***

Yes, yes. Both reported basis as well as obviously they are for constant currency as well.

Operator

(Operator Instructions) And our next question will come from the line of Ashwin Shirvaikar with Citi.

Ashwin Vassant Shirvaikar ***Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst***

Let me also start with congratulations, Shuky, and Tamar, for your added responsibilities. In the case of Shuky, obviously, new responsibilities as well. Eli, it's a little bittersweet. I'm very happy for you, but also will miss you. Every time we've spoken, I've learned a lot. So thank you for that. We wish you the best. I wanted to start by asking about, there are some comments with regards to North America restructuring, and then there is a specific mention of T-Mobile and Sprint. So I wanted to kind of parse that a little bit more to see if you're making a general statement with regards to a deal or is there's some financial information that we should know with regards to either that transaction or any details on the restructuring.

Tamar Rapaport-Dagim ***Amdocs Limited - CFO & Senior VP of Amdocs Management Ltd***

Ashwin, there is no direct relation whatsoever between our expectations on how we can support T-Mobile and Sprint and between the restructuring. And the restructuring is more related to some alignment we've done around recent acquisitions as well as the fact that we see the dynamics of demand in terms of skill set, locations, et cetera, within the business that we're seeing. For example, we're very excited to see the Comcast in a big deal. Obviously, that requires us to shift resources and build up capabilities around Philly. So this kind of changes our requirements, also alignment internally and this is exactly what we have planned.

Ashwin Vassant Shirvaikar ***Citigroup Inc, Research Division - Director and U.S. Computer and Business Services Analyst***

Got it. And then the relationship with AWS that you're setting up, it's -- I mean, I just want to get into some more details with regards to as you perhaps involve services like AWS more, how does that change the economics of your contracts?

Eli Gelman ***Amdocs Management Limited - Director, CEO and President***

Overall, it doesn't. It's just a component. Forget the -- we were not talking about this earlier on the specific project in the Philippines. In general, we are actually aligning our product sets to be cloud agnostic, but primarily, we are testing it, and we are offering a lot of this default on AWS. We have also strong relationship with Microsoft Azure and others. So we see -- in regular deals, we see the cloud management system as a component, we price it as part of the overall deal, and it's just an engine, instead of using our own data center or the customer data center or resources and so and so forth. We'll use a cloud management system from Amazon or from some other component. So the overall picture does not change. Specifically on project like this, when we team up with AWS, it's actually basically transforming certain components of Globe in this case onto the cloud. Some of it -- our application, some of it adjacent applications. So in this case, we just price it based on the capacity that we are consuming from the cloud. The beauty of it is that we show on one end to the services (inaudible) providers our capability to do that, and it's something that everybody in his life more or less needs. And on the other hand, the fact that we have a very close relationship with AWS that started by the way on the engineering side and went over to the commercial side, it means that they will call us and they have salespeople all over the place. And we hope that we will have other customers as well, actually, and require the same type of capabilities. So that's kind of the story about AWS, and it's very exciting relationship. We developed a lot of rapport based on our climate from the cloud. We are high-end structure. So simple to carry Amdocs application in the cloud. We started there, and we have all the relationships throughout there into the type of deals that we have now with Globe.

Operator

And I'm showing no further questions in queue at this time. So now it is my pleasure to hand the conference back over to Mr. Matt Smith, Head of Investor Relations, for some closing comments or remarks.

Matthew E. Smith ***Amdocs Limited - Secretary***

Thank you very much for joining the call today and for your interest in Amdocs. We look forward to hearing from you in the coming days. And if you do have any additional questions, please give us a call on the Investor Relations line. Have a great evening. Thanks.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude our program, and you may all disconnect. Everybody, have a wonderful day.