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DOX.OQ - Q3 2020 Amdocs Ltd Earnings Call

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OVERVIEW:

Co. reported 3Q20 revenues of $1.03b and GAAP diluted EPS of $0.90. Expects FY20 reported revenue growth of 1.1-2.1% and total revenue growth on constant-currency basis of roughly 1.6-2.6%. Expects 4Q20 revenues to be $1.015-1.055b and non-GAAP diluted EPS to be $1.16-1.22.

CORPORATE PARTICIPANTS

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

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

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

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Shaul Eyal *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Amdocs Q3 2020 Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference to your speaker today, Matt Smith, Head of Investor Relations. Please go ahead, sir.

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

Thank you very much, operator. 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 effects 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 risks include, but are not limited to, the effects of general economic conditions, the duration and severity of the COVID-19 pandemic and its impact on the global economy, 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, 2019, filed on December 16, 2019, and our Form 6-K furnished for the first quarter of fiscal '20 on February 18, 2020, and for the second fiscal quarter of fiscal '20 on May 18, 2020.

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: Shuky Sheffer, President and Chief Executive Officer of Amdocs Management Limited; and Tamar Rapaport-Dagim, Joint Chief Financial and Operating Officer.

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

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

Thank you, Matt, and good afternoon to everyone joining us today to our third fiscal quarter results. This was our first full quarter operating under the global condition of the COVID-19 pandemic, consider which I'm proud of the company's performance.

Revenue exceeded the midpoint of guidance and grew 1% year-over-year in constant currency. We delivered a significant number of live deployments, demonstrating incredible operating execution using remote deployment tools and methodologies. And we maintained stable profitability and robust free cash flow generation, the latter which was driven by healthy cash collection across our customer base.

Q3 was also notable for another record quarter in Managed Services, where revenue grew 4.6% year-over-year. This performance reflects the ramp-up of activities with new logos, a long-standing customer where we continue to expand our scope of work under a multiyear agreement with highly recurring revenue streams. Our ability to seamlessly operate the mission-critical system of our customer without interruption during the COVID-19 pandemic further underscore the value Amdocs consistently brings to our Managed Services model.

I'm pleased to say that we ended Q3 with a sequential and year-over-year increase in our 12 months backlog. Over -- after a slow start into the quarter, the pace of the deal signing accelerated as Q3 progressed, which we see an early but encouraging sign of business stabilization, following the disruption of March and April. Moreover, we see attractive and increasing pipeline of opportunity as our customer focus on the critical investments needed to strive the post-COVID-19 environment, including digital modernization in consumer and enterprise B2B, 5G deployment and monetization, system migration to the cloud and launching media and entertainment offering.

Amdocs is a best-in-class cloud-native engine to support such investment today, and we remain committed to investing in R&D and M&A to make sure we bring the innovation our customers will need in the future. Our recently announced acquisition of Openet to select our 5G and cloud migration capabilities is the prime example of this.

I will come back to Openet later in my remarks, but first let me provide an update of our activities by region in Q3. Beginning with North America. We delivered a positive year-over-year revenue growth as we continue to work closely with the region's largest service providers, many of which are leading the world in 5G investment in the journey to the cloud.

With AT&T, we continue to see momentum supporting a wide scope of activities that includes AT&T investment in customer experience, digital enablement, data analytics and security under the multiyear Managed Services deal we announced last November. More recently, we have partnered with Microsoft Azure to shift some AT&T IT application to the public cloud, and I'm pleased to say that we have now started a program to modernize AT&T's consumer mobility domain.

Let me also comment on T-Mobile and Sprint, which unified the operation under the T-Mobile brand nationwide on August 2. Amdocs is playing a key role enabling the new T-Mobile merger objectives with a wide range of activities, which reflects the deep relationship we have developed both T-Mobile and Sprint over many years. Move forward, we are continuing to work hard to demonstrate that we have the right credentials to be T-Mobile's key partner in support of future strategic requirements.

Across the broad in North America, we signed an expanded agreement with Bell Canada, which selected our real-time microservice portfolio to further increase its platform agility and accelerate its cloud strategy. And we won a multiyear deal with a leading Canadian operator under which Amdocs media's cloud-based platform will provide content aggregation, processing, compliance and delivery services.

Moving to Europe, performance was stable on a year-over-year basis. I'm pleased to report that we are on track with the large digit transformation projects we are progressing in Vodafone Germany and Orange Spain, both of which are adopting our latest next-generation offering deployed on modern cloud-native technology architects.

Recently, we completed the major transformation project in Three Ireland, the great success of which has led to our first project at much larger Three UK, where we have been selected as the prime system integrator in a multiyear Managed Services deal for its enterprise B2B segment.

Another example of our ability to expand within a major telecom galaxy is the Orange Group, where Amdocs is now partnering with Orange Liberia to order its end-to-end digital enablement platform, the opportunity of which resulted from initial entry point at Orange Spain. Additionally, Amdocs chosen by telecom in Israel to accelerate the pace of digital transformation across all business lines, and we also won new awards in the network domain to provide end-to-end cloud-native services orchestration solution to streamline and simplify the order and service delivery management processes for SES, the world-leading global satellite operator.

To summarize Europe, the breadth of our industry-leading product suite is providing highly relevant with new logos and existing customers. And we remain well positioned to sustain growth in the region over the long term.

Turning to the Rest of the World, where we are seeing contracts between stronger business conditions Southeast Asia and a slower press activity in Latin America. India was among the operational highlights of Q3. We will successfully migrate wonderful ideas, large rest of postpaid customers into a single digital experience platform that we enabled speedy introduction of new services, innovation price plan, binding operational efficiencies.

We also expanded our strategic partnership in the Philippines during the quarter. Globe Telecom choose our cloud-native CatalogONE and DigitalONE solution as part of a project to transform its enterprise operation and is also planning to use our customer flow management system to overcome COVID-19 related challenges in its retail store. Additionally, at PLDT, Amdocs was selected to accelerate the digital transformation of the enterprise business, fully automating the company's operation by modernizing and consolidating its operational support system across consumer and enterprise services offering.

We also remain encouraged by the positive signs of demand we are seeing for our media offering in the Rest of the World, such as Vrio Corp, AT&T Company, which has signed a multi-year agreement with Vubiquity to process Escuela content for DIRECTV in Latin America, SKY Brasil and DIRECTV GO.

Regarding the outlook in the Rest of the World, we are well positioned to support the stock pattern of opportunity in Southeast Asia, but market conditions are more challenging in Latin America, where service providers are weighing their discretionary spending requirements against a weak macroeconomic environment, the COVID-19 pandemic and potential market consolidation activity.

Now with my original comments completed, let me take a moment to discuss our planned acquisition of Openet, a leading provider of 5G charging policy and cloud technologies whose customers include server of the fourth top 10 service providers. Openet is part of our strategy to accelerate the pace at which we believe Amdocs can take the communication industry to the cloud while also helping service provider to differentiate in the 5G area.

The strategic rationale is threefold. First, open its world-class team of highly talented software professionals and build a new 5G charging policy and data management products, which are recognized worldwide for innovation at a modern and open cloud-native architecture. Second, we believe Openet's technologies naturally complement the multiplay capabilities of our hyperscale turbocharging platform as well as our 5G monetization and order handling solution, the combination of which should gradually strengthen our leading technology position relating to the Journey to the Cloud and 5G induction. Third, we see an exciting opportunity to bring Openet to a global customer base of more than 350 service providers to further succeed in the wave of 5G investments around cloud, edge compute, IoT, a new customer experience.

Overall, we believe Openet represents the right acquisition at the right time in the industry. And we look forward to welcoming the innovative team of software professionals to Amdocs upon closing later this quarter.

To wrap up, I'm proud of our Q3 performance in which we achieved our broad financial target with seamless operation acquisition using the modern virtual capabilities. With respect to our outlook for the remainder of the fiscal year, we are providing our current expectation based on information we have to date, but remind you that we are in a time of great uncertainty regarding the spread and severity of the COVID-19 pandemic and its adverse effects of the global economy remains.

With this in mind, we believe our business trends are gradually turning towards the reduction of growth. Our 12 months backlog is showing early but encouraging sign of stabilization and support and outlook for both [year-to-date] and sequential revenue growth in Q4 at the guidance midpoint without including Openet.

As such, we now expect to deliver revenue growth for the full year fiscal year between 1.6% to 2.6% on a constant currency basis, which is better than we expected 3 months ago. We are on track to generate normalized free cash flow of $500 million, which is slightly better than the original guidance of $488 million, which we provided at the beginning of our fiscal year.

Additionally, we've seen attractive and increasing pipeline of opportunities ahead of us, which we believe we can sustain future long-term growth as we leverage our market-leading and cutting-edge product offering, direct level of execution, pending of innovation and employee talents.

To add a final point, I would like to take a moment to recognize our global base of talented employees, to whom we are thankful for the extraordinary professionalism and commitment they have showed during the global pandemic.

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

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

Thank you, Shuky. Third fiscal quarter revenue of $1.03 billion exceeded the midpoint of our expectations of $990 million to $1.04 billion. Also after adjusting for positive impact from foreign currency of approximately $5 million compared to our guidance assumptions.

On a reported basis, revenue performance included a negative impact from foreign currency fluctuations of approximately $3 million relative to the second fiscal quarter of 2020. On a year-over-year basis, our third quarter revenue grew by 1% in constant currency.

Our third fiscal quarter non-GAAP operating margin was 17.1%, above the midpoint of our long-term target range of 16.5% to 17.5% and consistent with our guidance that we will protect profitability despite the COVID-19 related challenges. Below the operating line, non-GAAP net interest and other expense was $2.4 million in Q3, the mix of which includes higher interest expense related to our recent short-term borrowings and senior bond issue, offset by favorable foreign currency fluctuations.

For forward-looking purposes, we continue to expect 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.

Diluted non-GAAP EPS was $1.07 in Q3, above the midpoint of our guidance range of $1 to $1.08. As anticipated, our non-GAAP effective tax rate of 17.3% in third fiscal quarter was roughly in line with the high end of our annual target range of 13% to 17%. If you look at GAAP EPS, it was $0.90 for the third fiscal quarter, above the midpoint of our guidance range of $0.81 to $0.91.

Free cash flow was $146 million in Q3. This was comprised of cash flow from operations of approximately $187 million, less $41 million in net capital expenditures and other. Normalized free cash flow was $169 million in the third fiscal quarter, which is consistent with our guidance that free cash flow will convert at roughly 100% of non-GAAP net income in the second half of 2020.

Please refer to the reconciliation table provided in our Q3 earnings release for an explanation of the difference between normalized and reported free cash flow in the quarter and for the past periods. DSO of 85 days was unchanged year-over-year and up by 3 days as compared to the prior fiscal quarter, to remind you that DSO may fluctuate from quarter-to-quarter.

The sequential gap between unbilled receivables and deferred revenue widened by $7 million as compared to the second fiscal quarter of 2020, reflecting a decrease in total unbilled receivable of $10 million and a decrease in total deferred revenue, while short and long-term of $17 million. Relative to a year ago, the gap narrowed by $3 million. Changes in this gap are primarily due to the timing of contract-specific milestones relating to the transformation projects we are delivering for our customers.

Moving forward, we should expect unbilled receivables and total deferred revenue to fluctuate from quarter-to-quarter, in line with normal business expenses.

Moving on, our 12-month backlog was $3.48 billion at the end of the third fiscal quarter, up $20 million sequentially from the end of the prior quarter and equivalent to year-over-year growth of roughly 2.4%. As a reminder, we believe our 12-month backlog continues to serve as a good leading indicator of our forward-looking revenue.

I am pleased to report that revenue from Managed Services arrangements that generate high level of recurring revenue streams had a record quarter in Q3, comprising roughly 59% of total revenue. That reflects high renewal rates, the growing adoption of our managed transformation model and the continued expansion of activities within existing customers.

Our cash balance at the end of the third fiscal quarter was approximately $1.2 billion, including aggregate borrowings of $750 million. Our June 30 balance sheet does not reflect the annual acquisition -- sorry, the announced acquisition of Openet, which we expect will close in Q4 for a net consideration of roughly $180 million in cash.

During Q3, we see the opportunity to proactively raise $650 million by way of a (inaudible) bond issue at a historically attractive interest rate of 2.538%. And we also repaid our outstanding balance of $300 million under our $500 million revolving credit facility and an existing short-term loan of $50 million. An additional short-term backlog of $100 million remained outstanding as of June 30.

As an added point, we paid approximately $29 million in cash for the acquisition of business and intangible assets in Q3, the majority of which related to the purchase of a small software design and development company by our projekt202 subsidiary in support of our digital strategy. We remain comfortable with our balance sheet and believe that we have ample liquidity to support our ongoing business needs while retaining the capacity to fund strategic growth investments at and when the right opportunities arise. Additionally, we are committed to maintaining our investment-grade credit rating.

During the third fiscal quarter, we repurchased $60 million of our ordinary shares under our current authorization. As of June 30, we had roughly $769 million of authorized capacity for share repurchases with no stated expiration date, which we will execute at the company's discretion going forward.

Now turning to the outlook. The prevailing level of macroeconomic and business uncertainty surrounding the magnitude and duration of the COVID-19 pandemic remains elevated. The midpoint of our revenue guidance for Q4 reflects what we consider to be the most likely outcomes based on the information we have today, but we cannot predict all possible scenarios. And we remind you that our outlook may be impacted materials of customers continue to outpace their strategic business priorities and future pace to investors.

With that said, we expect revenue for the fourth fiscal quarter of 2020 to be within a range of $1.15 billion and $1.55 billion, which is better than what we previously forecasted. Embedded within our Q4 revenue guidance, we anticipate a sequential positive impact from foreign currency fluctuations of approximately $4 million as compared to Q3.

Our fourth fiscal quarter revenue outlook does not incorporate the announced acquisition of Openet as the transaction has not yet closed. For your long-term modeling purposes, we expect Openet to contribute roughly 1.5% to 2% of revenue growth in fiscal 2021. We will move quickly to bring Openet technologies into our broader portfolio of 5G offerings, naturally merging it with our core activities within a few quarters of closing the acquisition.

Regarding the full fiscal year 2020, we expect to deliver total revenue growth in the range of roughly 1.6% to 2.6% year-over-year on a constant currency basis without including Openet. The midpoint of the new range is approximately 10 basis points higher than that of our previous expectation of 0.5% to 3.5% year-over-year and highlights the resilience of our business model and ability to sustain growth during the pandemic.

On a reported basis, we now expect full year revenue growth in the range of 1.1% to 2.1% without including Openet as compared with the range of negative 0.5% to plus 2.5% previously disclosed. The new outlook anticipates a negative impact from foreign currency fluctuations of approximately 0.5% year-over-year as compared to a negative impact of 1% previously.

We anticipate our non-GAAP operating margin will remain at or above the midpoint of our unchanged annual target range of 16.5% to 17.5% in the fourth fiscal quarter and similar to the levels of the last couple of quarters. As we continue to operate within the environment of the ongoing pandemic, we remain focused on protecting our profitability without compromising operational excellence and one investing in the future engines of growth.

We expect the fourth fiscal quarter of diluted non-GAAP EPS to be in the range of $1.16 to $1.22. Our first fiscal quarter non-GAAP EPS guidance incorporates an expected average diluted share count of roughly 134 million shares. We excluded the impact of incremental future share buyback activity during the fourth fiscal quarter as the level of activity will depend on market position.

For the full fiscal year, we now expect to deliver diluted non-GAAP EPS growth of 1.6% to 3% year-over-year as compared to our prior expectation of 0 to 4%. We expect our non-GAAP effective tax rate to be within our annual target range of 13% to 17% for the full fiscal year 2020.

The impact of Openet on Amdocs non-GAAP diluted earnings per share is expected to be neutral in the full fiscal year 2020 and 2021 and accretive thereafter. We continue to expect normalized free cash flow for fiscal 2020 year of approximately $500 million, which is slightly higher than the original forecast of $480 million at the beginning of the year. We are raising our outlook for reported free cash flow for fiscal year 2020 to approximately $420 million compared to our previous quarter expectation of $400 million.

Reported free cash flow now includes anticipated capital expenditure of up to $70 million in relation to development of our new campus in Israel, and other items, which is reduced from our previous expectation of up to $90 million. Regarding our capital allocation plan, we expect to return the majority of our normalized free cash flow in fiscal 2020. With that said, we will continue to assess the deployment of capital carefully in the fourth fiscal quarter, having regard to the status of the COVID-19 pandemic, the outlook for M&A, financial markets and prevailing industry conditions.

To conclude my financial comments, we are pleased with the financial discipline we demonstrated in our Q3 performance. And we are encouraged to be providing an improved outlook on a sequential basis for Q4.

With that, we can turn it back now to the operator, and we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Shaul Eyal with Oppenheimer.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Congrats on the quarter, execution and the improved outlook. Two quick questions on mind. Shuky, we keep hearing -- we keep seeing that the new COVID-19 environment is exactly accelerating digital transformation journeys. When you talk to customers, what are they telling you about their spending priorities as it relates to this ongoing shift to the cloud, even within that shift, what could be prioritized first versus some other products or services?

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

So you are right. This is true that our customers are reducing the discretionary spending, but, I think, which it relates to the cloud journey and to digital transformation, which are really needed for the post-COVID-19 environment. This is where I think that they are not stopping. And actually, in some cases, they are accelerating. And I think everyone understand in the post-COVID-19 that retail stores are going to be closed, people are using much more digital capabilities, mobile application, website, et cetera. This is one. So digital trading or commerce become pretty much the standard. And the other thing is, obviously, that the migration to the cloud, getting rid of on-premise data center. This is something that started before the COVID-19 and actually accelerated by the COVID-19. So we do see a good trend and good opportunities in this domain.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

And I have a follow-up for Tamar. As the work from anywhere or work-from-home phenomenon continues to accelerate, are you having any second thoughts, any fresh thoughts about the campus being built in Israel? And maybe some of your other global branches, how to approach it longer term?

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

So when we look in our kind of philosophy around working from home versus working from the office, we believe that working together at the office creates very important environment of collaboration and innovation that is necessary in the tech world. Yes, flexibility is important. And to remind you, ahead of COVID-19, we were actually encouraging our employees on a global basis to work one day a week from home because we thought that flexibility matters. But as a matter of principle, we do hope to see a world where we can go back to more of a hybrid model. And we've taken that into consideration in planning our workspace globally as well as in the new campus build-up in Israel to create that kind of flexibility and take that into considerations in the planning.

Operator

Our next question comes from Jackson Ader with JPMorgan.

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

First one is on Openet. I think if we just look at tomorrow, you mentioned the expected contribution for maybe fiscal '21 is pretty much in line with what you guys said was the annual revenue for Openet for the last couple of years when you announced the acquisition. So just curious, what should we be expecting in terms of growth, either acceleration? What are the levers of growth? And with 5G deployments picking up, why wouldn't Openet maybe see a growth acceleration?

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

So when we look on the financial model that Openet had as a standalone company, it was a very difficult software product company, where the majority of revenue is coming from license, maintenance support and to some extent, later on with some professional services. We believe that in conjunction with the Amdocs portfolio of products, we can obviously take it to be something more robust and bigger over time. But the type of sales cycles that we see ourselves and same goes for Openet, such us usually take a bit more time. And then once you close the deal, it takes some time to ramp up the deal and recognize the revenue. So taking that into consideration and the fact that obviously, together, we want to accelerate the buildup of the pipeline and see that acceleration coming later on in the form of closing deals with Openet under the wings of Amdocs, we think that should accelerate, of course, over time.

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

Okay. Great. That makes sense. And then a quick follow-up, actually just sticking with Openet. In terms of maybe total opportunity just within the Amdocs customer base, which should be -- you mentioned that the third point, I think, for the strategic rationale was that you can now sell Openet to the global customer base of Amdocs. So how much overlap do you have in current customers now? And what do you think for the kind of total opportunity?

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

We have some overlap, but we have also a lot of customers that we have and they don't probably have much more customer that we have and they don't and makes a bit of the opposite. I think that the 5G charging of Openet, which is completely cloud-native and recognized probably the best in the market, adding to our -- obviously, our commerce, billing, real-time billing portfolio. I think this is a unique combination in the market. As everyone is moving to 5G, this cloud-native 5G charging is pretty much relevant to every service provider, obviously, to all the Apple's customer. So I think it's a great opportunity for us to come with holistic cloud-native solution that address all the 5G needs of our customers.

Operator

(Operator Instructions) Our next question comes from Will Power with Baird.

Charles Erlikh - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

This is Charlie Erlikh on for Will. I was hoping to stay with one net (sic) [Openet] and ask a question specifically on 5G. I'm wondering now with Openet in the portfolio, how would you compare your product portfolio as it relates to 5G compared to some of the other competitors that are also offering similar products? And then related to that, how would you characterize just the 5G opportunity in general in terms of the possibility to accelerate the top line and potentially the timing around that?

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

Obviously, I'm biased, but definitely, I believe that our portfolio in this domain is second to none. The -- I mean the -- all the monetization platform and our D1 and CatalogONE platform that, obviously, we believe this is the best in the market. Our real-time billing that we have and now we added the charging for 5G. I think it completes the solution end-to-end. And actually, we are going to integrate the Openet solution to our suite in a way that the same catalog of CatalogONE, which we, for example, we announced last quarter that another big North American service provider chose. By using the same catalog, we can have an end-to-end suite that support 5G. Now to your point, all our customers are moving to 5G. If I need to rank the world, probably North America is #1, Europe is second and APAC in third from adoption of 5G, all of them are looking to build capabilities for monetization and charging for 5G. And I think we have the right portfolio to address all these needs.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to Matt Smith for closing remarks.

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

Thank you very much for joining our 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 call the Investor Relations group. Have a great evening. Thanks.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.