Harris Stratex Networks January 30, 2008 Conference Call

Call Date:	**Wednesday, January 30, 2008**
Time:	**5:30 PM (ET); 2:30 PM (PT)**
Speakers Dial-in #:	**303-205-0066**
	Dial in 15 min. ahead of time

OPERATOR INTRO

Ladies and Gentlemen, thank you for standing by, and welcome to the Harris Stratex Networks conference call. At this time, all participants are in a listen-only mode. Later, we will open up the call for your questions. Instructions for queuing up will be provided at that time.

As a reminder, this conference call is being recorded for replay purposes.

I would now like to turn the conference call over to Mary McGowan of the Summit IR Group. Ms. McGowan you may begin.

MARY MCGOWAN

Thank you for joining us today to discuss the Harris Stratex Networks financial results for the Second Quarter of Fiscal 2008. On today's call will be Guy Campbell, president and chief executive officer, and Sally Dudash, vice president and chief financial officer.

During this conference call, we may make forward-looking statements regarding our business, including statements relating to:

- projections of earnings and revenues,
- the volume, timing and mix of our product orders,
- the timing and capabilities of new products,
- continued network expansion by mobile and private network operators,
- the timing of expected synergies and operating efficiencies, and
- the successful integration of the operations of the former Microwave Communications Division of Harris Corporation, which we'll refer to as MCD, with those of the former Stratex Networks, which we'll refer to as Stratex.

These and other forward-looking statements involve assumptions, risks, and uncertainties that could cause actual results to differ materially from those statements. For more information, please see the press release and filings made by the company with the SEC.

In addition, in the tables of our press release and on this teleconference, we may discuss certain information that is a non-GAAP financial measure. A reconciliation from the comparable GAAP measures is included in the tables of our press release and on the investor relations section of our company website, which is www.HarrisStratex.com. We believe the supplemental non-GAAP financial results, which are used by management, reflect the basic operating results of the company and will facilitate comparison of operating results across reporting periods.

Now, I would like to turn the call over to Guy Campbell.

GUY CAMPBELL

Thank you, Mary, and thanks to all of you for joining us today.

Our second quarter continued to demonstrate strong top line momentum. North America posted record second quarter revenues; the combined Asia Pacific/Latin America region surged 54% over the prior year and Network Operations climbed an impressive 30% year over year. To be sure, we still have areas that need work and opportunities that need to be captured, but we are proud that we are able to meet customer demand, be the provider of choice for many operators around the world and hold, or increase, our market share in key growth areas.

In the second quarter, we continued to see improvement in most financial metrics of the business. Let me share with you some of the highlights from our second quarter of fiscal 2008.

On a non-GAAP, sequential basis:

- Revenue for the December quarter increased 5 percent to $181 million
- Gross margin improved 100 basis points to 31%
- Net income increased 23% to $12 million, and
- Earnings per share increased 4 cents to $0.21.
- By segment,
    - North America revenue was solid at roughly $64 million
    - International revenue was approximately $111 million, and
    - Network Operations had another strong quarter with revenue of $6.5 million
- We have realized the expected cost savings of $14 million from our merger in the first half of fiscal 2008, and we are on track to achieve our $35 million goal for the full year.

While gross margin improvement did not rebound as much as expected, our strategy is still aimed at achieving margin expansion, which we believe is a formula for delivering shareholder value.

Later in the call, I will provide comments on our market and product positioning as well as an update on our financial guidance for the year. Now I'd like to turn the call over to Sally for a review of the quarter's financial details.

Sally …….

SALLY DUDASH

Thank you, Guy, and good afternoon everyone. Let me start with a review of the GAAP financial performance of Harris Stratex Networks for the quarter ended December 28, 2007.

Second quarter revenue was $181 million and we reported a net loss of $1 million or $0.02 per share.

We believe the supplemental non-GAAP financial results reflect the basic operating results of the company and will facilitate comparison of operating results across reporting periods. Our non-GAAP income statements exclude the charges that resulted from the merger transaction, integration costs, asset impairment, and stock compensation expense. Please refer to our website for complete GAAP to non-GAAP reconciliation tables.

For the second quarter of fiscal 2008, these non-GAAP charges totaled $17.6 million and are composed of the following:

- $7.6 million integration and restructuring charges
- $3.8 million asset impairment
- $3.6 million amortization of purchased intangibles
- $1.9 million stock compensation expense, and
- $700,000 amortization of fixed asset fair value step-up

The following discussion is based on non-GAAP results.

[REVENUE]

Revenue for the quarter at $181 million was an increase of 5 percent compared to Q1 and also a 5 percent increase from the second quarter of fiscal 2007. New product revenue, which we define as revenue from products less than 3 years old, was 61 percent of total revenue.

By segment, North America microwave contributed a record $64 million of revenue, 13 percent higher than Q1 and increased over the year ago quarter. Q2 is traditionally our strongest quarter in this segment. North American revenue in Q2 saw strength from increased bandwidth demand, footprint expansion, and 2 GHz microwave relocation for Advanced Wireless Services from mobile operators.

The Network Operations segment contributed $6.5 million in revenue in the quarter, comparable to the first quarter of the year and 30 percent higher than Q2 of fiscal 2007. Increased demand for this segment's Service Assurance Solution with Next Generation Network customers is fueling revenue growth.

Gross margins in both of these segments are on plan and delivering to our expected results.

The International microwave segment contributed $111 million of revenue in the second quarter, also comparable to Q1 and 7 percent higher than the year ago period. Strong gains were achieved in our combined Latin America and Asia Pacific region, with a 57 percent sequential increase in revenue, as the company's focus on capturing new customers, particularly in Asia Pacific, gained traction. Revenue from EMER was comparable to the first quarter and Africa revenue decreased by 28 percent compared to Q1, as a result of operator consolidations and slower implementation of 3G networks in these regions.

[GROSS MARGIN]

Gross margin was 31.1 percent compared to 33.9 percent in the second quarter of fiscal 2007 and up from 30.1 percent in the first quarter of fiscal 2008.

Compared to the first quarter, we were able to recoup one percentage point in gross margin vs. the two percent that we had anticipated. Product mix returned to more normal levels, which would have produced the 2 percent improvement. However, overall gross margins were impacted unfavorably by a combination of a mix shift between the Africa region and Latin America / Asia Pac and an increase in the cost of services and freight compared to Q1 and our expectations. We are taking immediate steps to reduce the added costs to improve performance in the second half.

[OPEX]

Total operating expenses declined from $40 million or 23 percent of revenue in the second quarter of fiscal 2007 to $39 million or 22 percent of revenue in Q2 of 2008, however OPEX increased by $900,000 compared to the first quarter of fiscal 2008. Although expense synergies are being realized according to our plan, we have seen an increase in G&A related primarily to ensuring SOX readiness for the new company that was not previously anticipated at the levels we have experienced. R&D spending was $11 million in the second quarter, or 6 percent of sales. We are addressing the spending in G&A to return to planned levels in the second half of the year.

Depreciation and amortization of property, plant and equipment and capitalized software was $4 million. CAPEX for the quarter was $4 million.

[OPERATING INCOME & NET INCOME]

Operating income was $16.8 million, and net income was $12.1 million, or $0.21 per share, an increase of 24% from Q1. Our pro-forma tax rate remains at 26 percent, and our cash tax rate remains at 2 to 3 percent.

[HEADCOUNT]

Employee headcount was reduced in the quarter from 1410 to 1400, and is in line with our integration plans for headcount reductions.

[BALANCE SHEET]

Moving on to the balance sheet, Harris Stratex' cash balance including short-term investments was $83 million at the end of December, compared to $79 million at the end of September. Operating cash flow for the quarter was $10M, an improvement of $8 million from the first quarter.

Inventory and unbilled decreased by $12 million in the quarter, primarily from billing milestones being reached on several of our large North America systems projects. Inventory turns, including unbilled, were 2.8 compared to 2.5 in Q1 FY08. We had an increase in DSOs to 112 days in Q2 compared to 107 in Q1, but this was the result of the billings achieved on the North America jobs that moved into A/R as noted above, and the fact that most of this occurred in December. We expect these receivables will be collected within the current quarter. We continue our initiatives to decrease DSOs and improve inventory turns and are encouraged with the overall balance sheet progress in the quarter.

And now I will turn the call back over to Guy for a market and outlook discussion.

Guy…

GUY CAMPBELL

Thank you, Sally.

[MARKET]

Let me talk about our markets, our growth opportunities and some of the successes we are seeing.

Global wireless momentum is indeed everywhere. Mobile networks will cover 90% of the world population by 2010. There is steady existing and new network growth. 3G subscriptions grew 90% in 2007, and the traffic generated by mobile networks tripled. There is growing demand for greater bandwidth, especially in backhaul networks.

[MARKETS/CUSTOMER PROOFPOINTS]

This past quarter we continued to see revenue momentum and strong customer demand across our major business segments.

[NORTH AMERICA]

In North America we saw record revenue this quarter. This is in a market typically dominated by leased lines, but where increasing leased line substitution due to network footprint expansion and the need for more bandwidth is creating strong demand for our products and services.

In North America we're seeing demand driven by the migration from 2G to 3G, and we continue to see spending for 2 GHz microwave relocation for Advanced Wireless Services. We believe the utilization of new spectrum from the Advanced Wireless Services auction could provide an overall opportunity of up to $150 million in North America over the next 2 to 3 years.

In Q2, the split between mobile operators and private networks was 68% vs. 32%. As you may recall, the split taken over a 12-month period is typically 50/50. We would not be surprised if leased line substitution and other North America mobile network revenue drivers continued to move the revenue distribution more heavily aligned towards the mobile operators.

Despite this possible revenue shift, private and Government networks remain an important part of our customer base. In Q2 we announced a contract with the Columbia River Inter-Tribal Fish Commission for our Constellation radios. This deployment will enhance Oregon's statewide communications and public safety backbone network. We also see the availability of homeland security funding enabling increased growth in private networks. I am pleased to announce that Harris Stratex has been selected by Boeing as a digital microwave subsystem provider for the Secure Border Initiative Network. At the local government level, we have been awarded a $7.7 million contract by the San Jose City Council to furnish and install the ECOMM microwave interoperable communications system carrying dispatch traffic for police, fire and emergency medical services. These are clear examples of private networks seeking our expertise in designing and building transmission networks for mission-critical applications.

The record levels of revenue in North America were achieved with strong gross margin levels. We believe this strength can be attributed to our customer-centric focus, our end-to-end transmission capabilities, transport, access and carrier-grade Ethernet systems and software, network management solutions and turnkey professional services.

During Q2, we co-sponsored a survey of mobile operators' backhaul requirements with a leading market research firm. One of the findings applicable to all our markets was that existing backhaul traffic capacity is increasingly stressed, but also that the operators must find ways of handling this capacity without significant increases in Cap-ex or Op-ex budgets. This provides Harris Stratex with an opportunity for traffic engineering and backhaul capacity management using our Service Assurance tools, whether with wireless or other transmission technologies.

As I've said many times before, a key differentiator for us is the breadth of product portfolio. We provide solutions for all types of wireless networks – from low-capacity voice networks to high-capacity IP networks supplying voice, video and data all on the same network. In addition, we offer services to help customers worldwide monitor and manage their networks, an area where we are seeing greater success with key network management wins.

[NETWORK OPERATIONS]

That brings us to our Network Operations segment whose impressive 30% year-over-year growth is driven by our NetBoss product suite. Our network management capability is not the typical element manager capability that many independents have in our space. Our NetBoss product suite and turn-key services provide our customers with top level management systems to effectively operate all elements of their voice, data, and video networks.

We are increasingly seeing Network Operations opportunities – and executing on them – worldwide, especially in the Middle East and Africa.

As testimonial, we recently announced that, Du, a service provider in the United Arab Emirates purchased a service assurance system for its network based on our NetBoss product suite. NetBoss will provide a comprehensive solution for this customer's quad-play network, which offers voice, data and video services over a converged fixed and mobile network.

Also in Q2, we announced the selection of NetBoss by Bahrain-based Batelco, a leading regional telecom provider. We'll deploy an advanced NetBoss Service Assurance Solution for Batelco's transport and next generation networks.

[INTERNATIONAL]

As Sally pointed out, our revenues in International increased 7 percent over the year ago period with strength across most major business segments. The drivers are new Greenfield networks; continued subscriber growth, mobile network expansions, and backhaul traffic increases; and the transition to IP transport in operator networks.

It is worth noting that the pace of growth can be sporadic depending on the region. Variability due to the timing of large network rollouts as well as impacts from civil unrest can and will occur, but we believe the global scope of our operations enables us to maintain the trend of revenue momentum we have demonstrated.

In Asia Pacific and Latin America, we are clearly improving our market position. Revenue saw a jump of 54% year-over-year, which positions us well for the future.

In Asia Pacific we are gaining market share, and we won new accounts in countries that included India, China, the Philippines, Sri Lanka, and New Zealand, and we engaged in a number of 3G expansion rollouts with Eclipse Super PDH radios. We believe these sales will provide us with the opportunity to improve our margins as customers expand their capacity through software upgrades. Earlier this month we announced a win with iZZinet, a Malaysian service operator, to provide Eclipse radios for its nationwide wireless broadband network roll-out program. Our system engineers from the Asia Pacific region created a unique network design with all radio links transporting Carrier-grade Ethernet services for this innovative operator.

Africa remains a key growth area, and we are seeing a pick-up in activity as new orders and new partnerships emerge. Our position in this region remains strong even while the market is undergoing disruption from mobile operator consolidation and, to a lesser extent, civil unrest in some countries. Earlier this month we announced a multi-million dollar agreement with Starcomms, Nigeria's leading CDMA operator to supply Eclipse radios as part of their 3G network expansion into new cities throughout Nigeria. Our continued selection to work with the largest operators throughout Africa is testimony to our strong reputation and long-standing relationships in the region.

We were met with challenges in Europe, the Middle East and Russia in Q2. In Russia, we experienced a lag in sales due to slower implementation of 3G upgrades. But we remain close to our customers here and see a number of opportunities in Russia on the horizon. In the Middle East, we saw a number of push-outs to Q3 improving our backlog as we enter the quarter. In Europe we secured some significant wins, and there are a number of opportunities that we are pursuing aggressively. In December we announced one such win with Sonaecom, a Portuguese operator. Here we'll connect base station transceivers across northern Portugal using the Eclipse platform and a range of services including network design, site surveys, installation, commissioning and training. In countries such as Portugal, where leased line prices remain relatively high, there is a strong business case for using microwave radios in the access and backhaul network when deploying or upgrading wireless networks to offer new, high-speed mobile Internet services. Because of its carrier-grade Ethernet transport capability, Eclipse is quickly becoming the first-choice backhaul solution for mobile broadband wireless providers.

[WiMAX]

Other areas of interest include WiMAX where the adoption continues to progress as networks are being deployed. The number of WiMAX networks we are participating in is increasing with opportunities extending to international markets including Europe, Africa and the Middle East. During the quarter we added a number of key WiMAX customers—let me tell you about two of them.

TDF, a French converged service provider, will deploy our Eclipse wireless transport platform to provide high-speed, Gigabit Ethernet connections for their WiMAX network. As radio frequencies become more difficult to obtain in France, the ability to deploy high-capacity links in the minimum bandwidth enables

TDF to deploy links in regions where frequencies may not otherwise be available. Our ability to provide scaleable bandwidth from 10 to over 600 Mbit/s in a single radio channel was a clear differentiator.

Another recent win was with French WiMAX operator, Altitude. This network will also be based on our Eclipse microwave radio, which is ideally suited to support WiMAX backhaul traffic. Eclipse has proven to be the reliable product of choice for WiMAX backhaul as the only radio to support Carrier Ethernet transport with Layer 2 quality of service. We continue to be engaged in consulting for IP transport network design, traffic optimization, planning and turnkey implementation for WiMAX networks in addition to providing backhaul solutions.

[PRODUCTS]

Now, let me talk about our products.

Customers depend on us to develop differentiating technology and offer a breadth of solutions. Our investment in R&D remains as large as any in our industry and will continue to fuel our product innovation. This engineering commitment enables us to maintain our technology leadership and offer our customers superior solutions and services.

In Q2 we introduced and began shipments of a new Eclipse Gigabit Ethernet system, which also is TDM capable. In addition to meeting the needs for operators using pure IP transport, this new product delivers an ideal solution for operators requiring TDM services today, with a software migration to Gigabit Ethernet tomorrow. Eclipse Gigabit Ethernet, as well as the other Eclipse Ethernet offerings have superior throughput and packet-handling capabilities, as well as highly competitive networking features, and have been gaining momentum in the pure-IP segment of the market as well as in applications using both TDM and IP.

As a reminder, TRuepoint 6400, an all-indoor radio solution, began shipping in Q1 in North America for deployment of an all-IP network in Kentucky. Its introduction represents an opportunity for revenue and margin improvement in the high-capacity transport segment of the market. Product shipments increased in Q2 and will continue to ramp in the coming quarters.

We will continue to roll out additional TRuepoint 6400 frequencies, capacities and software defined features in the coming quarters. Market feedback for the TRuepoint 6400 continues to be very positive, and we expect these new feature releases will help drive North America orders for the balance of FY08 and beyond.

We are now actively selling the TRuepoint 6500, which offers a full-featured long haul trunking platform. We expect to start delivering this solution in the second half of the year.

Looking farther ahead to calendar 2009, we are working on our next generation Ethernet-based product platform. This platform, which combines the best-of-the-best from our TRuepoint and Eclipse platforms, plus new innovations, has exciting potential. We are prioritizing our development efforts into the largest growth areas. We expect this platform to deliver new levels of product performance and cost efficiency while supporting our customers' network evolution to Ethernet transport.

As has been our practice in the past, we will continue to support our legacy products and to meet our customers' needs.

Our innovative product line is a clear differentiator and our professional and support services help us create long-term customer relationships. We lead the industry in our commitment to customer service, engineering excellence and comprehensive field services. Our services cover the complete cycle of network implementation—from analysis, planning, design, and systems integration to site build, deployment, network monitoring and training. These service capabilities have enabled us to forge sustainable long-term relationships with our customers.

[OUTLOOK & GUIDANCE]

Before going to Q&A, I'd like to provide an update on our company's guidance for the year.

Based on our results through the first half of fiscal 2008, we have revised our outlook. Demand remains strong, and our targeted regions of the world are still growing despite difficult environments from time to time. With North America's record revenue growth this past quarter and the gains in the combined Asia Pacific/Latin America region, which was targeted as a growth opportunity earlier this fiscal year, we are confident that we are increasing our overall market share. Network Operations is quickly establishing itself as an important differentiator in customer decision-making and underscores our customer-centric approach to this business. We remain bullish on our outlook for top line growth through the second half of fiscal 2008 and beyond as we expand into emerging markets. All of these factors give us the confidence to increase our revenue expectations for fiscal 2008 from our original forecast of between $670 million and $702 million to between $700 and $720 million.

As I already mentioned, we are on track to achieve our goal of $35 million in cost synergies by fiscal year end. However, the full effect is not flowing through to our bottom line. Factors such as customer, product and geographic mix continued to hamper our efforts to expand margins. We saw this in the first quarter and, while we did achieve a 100 basis point improvement in Q2, it was not the 200 basis points we anticipated. Our strategy is still aimed at achieving margin expansion, which we believe is a formula for delivering shareholder value. We expect to accomplish this through continued operating efficiencies, additional product cost reductions, and new product introductions.

However we now believe that the customer, product and geographic mix that we experienced in the first half of the year will continue into the second half, and this will limit **the rate** at which we can expand margins this fiscal year. Therefore, we are adjusting our EPS expectations.

Non-GAAP earnings per share are now expected to range between $0.85 and $0.95 for fiscal 2008. While this EPS adjustment is a disappointment, the forecasted improvement of 24-50% in the second half of fiscal 2008 versus the first half does show solid sequential improvement and good momentum for Harris Stratex.

We believe that our top line growth will continue, aided by our planned new product introductions. The TRuepoint 6000 family, which has strong gross margins, will continue to ramp sales over the coming quarters. And the planned additions to the already extensive capabilities of the Eclipse product line will enable Harris Stratex to increase its position in the Carrier Ethernet and IP networking space which will further drive revenue with higher margins.

I believe these new higher-margin product introductions, in addition to continued value engineering, and additional cost-saving initiatives within operations, will result in improvements in our earnings for the second half of 2008 and beyond.

Once again I would like to thank the employees of Harris Stratex Networks around the world for their talent, dedication and efforts.

At this point, I'll ask the operator to open the line for your questions.

[Q&A SESSION]

[CLOSING REMARKS]

MARY MCGOWAN

This concludes our conference call. Thank you all for joining us on this call and webcast today.