

BluePhoenix Solutions Ltd.

Q2/2010

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Operator: Good morning and welcome to the BluePhoenix second quarter financial results conference call. All participants have been placed on a listen-only mode, and the floor will be open for questions and comments following the presentation. At this time, I would like to turn the floor over to your host, Nir Peles, chief financial officer of Blue Phoenix. Nir, you may begin.

Nir Peles: Thank you. Good morning and thank you for joining us for today's conference call to discuss BluePhoenix Solutions' second quarter 2010 financial results for the period ended June 30, 2010. Before we begin, I would like to point out that during the course of the conference call, there may be statements made relating to future results of the company that are forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995. Actual results, performance or achievements, could differ materially from those anticipated in such forward-looking statements as a result of certain factors, including those set forth in the company's filing with the Securities and Exchange Commission. An ... version of the conference call will shortly be accessible at our website at www.bphx.com. At this time, I would like to introduce Arik Kilman, chief executive officer of BluePhoenix. Arik, the floor is yours.

Arik Kilman: Thank you, Nir, and thank you everyone for joining us today. In a moment, I will ask Nir to review the details of our financial results for the second quarter period. But first I'd like to start with a quick summary

of our results for the quarters. Revenues were \$16.2 million. Our non-GAAP operating profit was \$1.3 million or 8% of revenues. Our non-GAAP EPS was 1 cent. Backlog is \$76 million, after a reduction of approximately \$9 million from the consulting business, that was sold, up \$3 million from the last quarter, on an apples-to-apples basis. Pipeline, approximately \$220 million. It should be noted that our results were negatively affected by an exchange rate fluctuation which caused a reduction of approximately 700,000 in revenues and \$400,000 in expenses, if Q1 exchange rates were in effect. In addition, we had exchange rate losses of \$580,000 which are recorded in our financial expenses. During the second quarter, we started implementing our plan that we outlined last quarter. This plan involves selling certain non-core less-profitable activities while maintaining the focus on higher-margin IT and knowledge modernization, and at the same time strengthening our balance sheet. In addition, we stated that we intend to put an increased emphasis on cash flow from operations to continue the expense control as well as improving contractual terms, and that we expect to go back to positive cash flow from operations, no later than the third quarter. Finally, the plan involves focusing on relationships with strategic technology and system integration partners. We believe that teaming up with large partners can open the door to every major potential customer in the world and will change our business model to sell more licenses of our tools and less services. We expect to close at least one deal with a large partner before the year ends. If we look at Q2, we can see that the execution of such plan had begun. Our revenues and non-GAAP EPS came at the higher end of our guidance range. We have positive cash flow from operation, excluding payments for our cost savings plans, and

we sold a portion of our consulting business, which was announced at the beginning of July. This business contributed approximately \$1.5 million of our second quarter sales, which will not recur during the third quarter. I'm going to now call the turn over to Nir to discuss the financial results for the second quarter. After that, I will make a few closing comments and open the floor for questions and answers. Nir?

Nir Peles: Thank you, Arik. Please note, that all references to our earnings numbers, unless stated otherwise, would be to our non-GAAP figures. Please refer to our press release for reconciliation of our GAAP to non-GAAP figure. Revenues for the quarter were at \$16.2 million. Revenues from legacy and knowledge modernization represented 53% of our revenues, including 12% for maintenance, 31% from software licenses, and 10% from ten key projects. The remaining 47% are generated from professional services, which are based on standard material. The revenue break our geographically for the quarter was 54% Europe; 21% North America; and 25% in the rest of the world. 49% of our revenues were attributed to our financial and insurance industry. 51% were attributed to government and other sectors. Gross margins for the quarter were 55% this quarter compared to 53% in the previous quarter. Overall expenses were at \$14.8 million this quarter, compared to \$16.4 million in the prior quarter. Our operating profit was \$1.3 million or 8% of revenues. We had net financial expenses of \$900,000, including \$500,000 of foreign exchange losses. Net income was \$126,000. EPS for the quarter was a profit of 1 cent per diluted share. The EPS is calculated based on 23.6 million shares outstanding. Turning to our balance sheet, we completed the second quarter with \$19.4 million in cash. Cash flow from operations was positive \$0.3 million, excluding payments relating to our cost

savings plan. Our total head count as of the end of the quarter was 732. Subsequent to quarter end, we have reduced the head count to 660 employees. Our DSOs for the first quarter was 138 days. Our goal is to bring DSO down to 120 by the end of the year. With that, I will now turn the call back over to Arik for some additional comments. Arik, go ahead.

Arik Kilman: Let me speak to our outlook. As I mentioned, at the beginning of July we sold a portion of our consulting business that contributed approximately \$1.5 million of quarterly revenues. We currently expect Q3 and Q4 revenues to be approximately 13 to 14 million, and non-GAAP EPS to be between -2 to +2 cents. As we implement our plan, we'll focus on improving our profitability to concentrating on sales of tools and IT modernization business, as well as focus on other lines of business, including knowledge modernization. We expect the results to be smaller, but much more profitable company, and one which forms the basis for organic growth. Our preliminary guidance for 2011 is 45 to 50 million in revenues, a non-GAAP EPS of 10 to 15 cents. With that, I will open the call to any questions, if you have. Operator?

Operator: Thank you. Ladies and gentlemen, at this time we will begin the question and answer session. If you have a question, please press *1. If you wish to cancel your request, please press *2. If you are using speaker equipment, kindly lift the handset before pressing the numbers. Your questions will be polled in the order they are received. Please stand by while we poll for your questions. The first question is from Nathan Schneiderman of Roth Capital Partners. Please go ahead.

Nathan Schneiderman: Hi, Arik and Nir. Thanks very much for taking my questions. What was the total dollar value of new deals signed during the quarter? Last quarter I have that at 14 million.

Arik Kilman: No, the total value, the total value was 19 million.

Nathan Schneiderman: This quarter it was 19 million?

Arik Kilman: Yes. One-nine.

Nathan Schneiderman: Okay. And that \$6 million deal with the European bank that you announced, that included, in early July, that included 4 million of licenses, when does that, when does that hit the income statement, and in which line item? So for example, is all the 4 million in license, or in the revenue line in Q3? Is some of it hitting other income instead of revenue? Just how does that flow through the numbers?

Arik Kilman: The number of the license was 3 million, and the rest was maintenance. And the license was recorded in Q2. And the maintenance over the next few years.

Nathan Schneiderman: So 3 million of the license was in the Q2 number, and the rest you said is basically amortized in revenue over the next, you said two years?

Arik Kilman: In the next few years. We have this deal had 4 portions. One was the license. The other one was maintenance. The third one was services, contracts which did not start and which start in Q3, and the fourth one was the sale of the consulting that we didn't recognize yet. So of the 6.2 million, 3 million was recognized in Q2.

Nathan Schneiderman: Okay. And does, the sale of the consultants would be recognized in Q3?

Arik Kilman: Yes.

Nathan Schneiderman: Okay. The decline in, the decline in the software development fees, it was down more than a million sequentially. Can you guys talk about that?

Arik Kilman: Yes. We, as you know, we're implementing a cost savings plan. And we

want to stabilize our tools and stop selling them as software. And we let go people in Q2. And I said, we reduced the head count, as Nir said, we reduced the head count from 732 to 660 in Q3. We continue to let people go and reduce the cost of services and R&D.

Nathan Schneiderman: Okay. I guess the final area, question area for you, and then I'll drop off. So the, I'm just curious on your guidance view for 2011, and just the mechanics of that. Because, you know, I gather from the shift off with consulting resources that would be about maybe a 6 million annual hit to the revenue run rate. And I'm just surprised that you only think the business is going to do the 45 to 50 million in 2011. Does that incorporate estimates for additional divestitures? Or what's embedded in that view of the 45 to 50 million for next year?

Arik Kilman: First of all, we want, as I said, in the call, we would like to focus on higher margin business, but we are not going to run after nonprofit level or lower margin projects in legacy modernization. Secondly, this is too early to say. And we made some assumptions of divesting some of the business, which I cannot disclose right now. Third one, at this stage, we would like to take a conservative approach. And most important stuff is that we we're shooting for 10% operating margins on these numbers. So though revenues might be lower, as we predict right now, operating margin will be 10% and that's what we're shooting at. As I said, might be a smaller company with higher margins and poised for growth.

Nathan Schneiderman: Okay. Okay. Thank you very much.

Arik Kilman: Okay.

Operator: The next question is from Jeff Van Rhee of Craig Hallum. Please go ahead.

Jeff Van Rhee: Great thanks, Arik. Just a couple questions. First, just you talked

about the SI relation,

Arik Kilman: We can't hear, Jeff.

Operator: I'm sorry, we're going to have to disconnect the questioner, and hopefully he will call in again. If there are any additional questions, please press *1. If you wish to cancel your request, please press *2. Please stand by while we poll for more questions. The next question is a follow-up question from Mr. Nathan Schneiderman of Roth Capital. Please go ahead.

Nathan Schneiderman: Hi. Since the line went a little bit soft, I just thought I'd come in with a few other quick questions. The other income came in at positive 600,000, yet you spoke to nearly that same amount of FX losses. I was curious how that worked.

Arik Kilman: Can you repeat the question?

Nathan Schneiderman: Just I was hoping you could talk about the other income and the dynamic there?

Arik Kilman: This is the warrant valuation with respect to warrants that were given to investors in a deal that we did in the last year.

Nathan Schneiderman: Okay, okay. Got it. I'm sorry,

Arik Kilman: Only on a GAAP basis.

Nathan Schneiderman: Okay. I think I made a mistake looking at my numbers. And then hey, the final question for you here. What else, what else are you looking to divest at this point?

Arik Kilman: As we said, it's too early to say, and I wouldn't like to talk clearly about that. But we have some tools that we've developed over the years. And they require long sales cycles and long sales efforts. And the projects were not profitable. So while keeping the tools as light tool, I believe that we are going to find buyers for them because they are needed by some

other system integrators or other companies. And that's mainly what we are going to be focusing on.

Nathan Schneiderman: Okay. Thank you.

Arik Kilman: Okay.

Operator: The next question is from Jeff Van Rhee of Craig Hallum. Please go ahead, sir.

Jeff Van Rhee: Arik, can you hear me now?

Arik Kilman: Well, we can hear you better.

Jeff Van Rhee: Okay good. Just two questions. You talked about the SI relationships and you've talked at length about the pipeline of light efforts to really drive more license sales. Can you just expand on the partnerships and relationships? I know that was an effort of Yaron's, and where we are in that, where you're seeing success, where you're not seeing success?

Arik Kilman: We had one partner that we're making real nice progress with it. And as I said, we expect to sign a deal before the end of the year. I expect that this deal can change the business model of the company, because we're going to do, to sell a lot of licenses and services and software with this partner, and he's going to take it to the market in a way that we plan right now. It's too early to say, because it's not signed yet. But we're making slow and steady progress with this partner. There's another partner that we're talking with. He's far behind. And I don't expect anything to be signed with him until the end of the year. They are some European local partners that we signing. They are small partners. Currently we didn't include them in our business model for 2011.

Jeff Van Rhee: And just refresh me here, what does the sales force look like right now? You know the structure the number of heads?

Arik Kilman: 14 sales, corporate caring reps and 4 sales support. But that's including, that's including also our knowledge modernization. And talking about partners, we have, in the knowledge modernization space, we have signed a partner which hopefully will work with us closely and also bring sales of software to that part of the business.

Jeff Van Rhee: Okay. Good. I think I'm all set. Thank you.

Arik Kilman: Thanks, Jeff.

Operator: There are no further questions at this time. Before I turn the call over to Mr. Kilman for the concluding statement, I would like to remind participants that a replay of this call will be available in two hours. In the US please call: 1-888-782-4291. In Israel, please call: 03-925-5936. Internationally, please call: 972-3-925-5936. Mr. Kilman, would you like to make your concluding statement?

Arik Kilman: Just to say thanks to everyone for being with us in this conference call. And I will take the next call in the first half of November 2010. Thank you very much. Have a nice day.

Operator: Thank you. This concludes the BluePhoenix Solutions Ltd. second quarter 2010 results conference call. Thank you for your participation. You may go ahead and disconnect.
(End of conference call)