NetScout Systems, Inc.
First-Quarter Fiscal Year 2016 Financial Results Conference Call
Management's Prepared Remarks

July 30, 2015

A. Kramer: Safe Harbor Statement and Other Details

Thank you and good morning everyone. Welcome to NetScout's fiscal year 2016 first quarter conference call for the period ended June 30, 2015. Joining me on this morning's call are:

- Anil Singhal, NetScout's co-founder, president and CEO;
- Michael Szabados, NetScout's chief operating officer; and
- Jean Bua, NetScout's senior vice president and chief financial officer

We have included a slide presentation of key financial data that accompanies the financial section of our prepared remarks. For those listeners who have dialed into the call this morning and would like to view this slide presentation, you can find it by going to our website at www.netscout.com/investors and then clicking on today's webcast. You can advance the slides in the webcast viewer to follow along with our commentary. We will try to remember to call out the slide number we are referencing in our remarks.

In terms of our agenda for today's call, Anil Singhal will first provide an overview on our first-quarter results and share his perspective on our business going forward and the opportunities we see now that our acquisition of Danaher's Communication Business has been completed. Our COO Michael Szabados will offer some insights on near-term integration activity and key drivers for customer adoption. CFO Jean Bua will then provide additional detail on our first quarter financial performance as well as discuss our guidance.

Slide #3: Safe Harbor Statement and Non-GAAP Financial Metrics

Moving on to slide #3:

Safe Harbor Statement

I would like to remind everybody listening that forward-looking statements in this presentation are made pursuant to the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, and other federal securities laws. Investors are cautioned that statements in this presentation, which are not strictly historical statements, constitute forward-looking statements which involve risks and uncertainties. These include without limitation, our financial guidance, anticipated share repurchase, product development plans, adoption by customers, the anticipated benefits of NetScout's acquisition of communications business lines of Danaher Corporation, and the performance of the combined company. Actual results could differ materially from the forward-looking statements. Risks and uncertainties which could cause actual results to differ include, without limitation, the other risk factors outlined in today's press release, and NetScout's Annual Report on Form 10-K for the fiscal year ended March 31, 2015, which is on file with the Securities and Exchange Commission and available on our website. NetScout assumes no obligation to update any forward-looking information contained in this press release or with respect to the announcements described herein.

Non-GAAP Reconciliation

Finally, I would like to remind you all that while the slide presentation includes both

GAAP and Non-GAAP results, unless otherwise stated, financial information discussed on today's conference call will be on a non-GAAP basis only. Non-GAAP items are described and reconciled to GAAP results in today's press release and they are included at the end of the slide presentation that is made available online on our website. I would also note that growth rate discussions are based on a year- over-year basis unless otherwise noted.

As detailed in our press release today, NetScout reported first-quarter results that were within the range of guidance we offered in late April. More importantly, two weeks ago, we achieved a major strategic milestone when we successfully completed our acquisition of Danaher's Communications Business. As Anil will detail, this transaction accelerates NetScout's strategic progress and positions the Company for long-term success. Jean will offer further detail on our outlook for the remainder of the fiscal year.

And, with that said, I will turn the call over to Anil and then my other colleagues to expand on these and other points. Anil, please go ahead.

Anil Singhal

Thank you Andy.

The past several quarters, and most certainly the past several weeks, have been very energizing for NetScout with the completion of the transformative acquisition of Danaher's Communication Business. At the same time, our team stayed focused on addressing our customers' needs, which enabled us to report a solid first-quarter performance, in line with the guidance we had provided. Our results this quarter were marked by revenue in excess of one hundred million dollars and solid non-GAAP profitability. While I will provide some perspective into our first-quarter results in just a moment, I will spend the majority of my time outlining our perspective on the transaction and why we are positive that this transaction will help us create significant value over the long term for all of our key stakeholders.

Before I do that, I wanted to make sure I expressed our thanks to all of our shareholders for the tremendous support we received at the special meeting last month when approximately 98% of those voting voted in favor of the primary proposal related to the transaction. On a related note, I also want to welcome our new shareholders who have invested more recently in NetScout either by tendering their ownership of Danaher stock or in purchasing our stock in the weeks leading up to or following the completion of the acquisition.

This transaction has the potential to significantly accelerate the strategic plans that we put in place several years ago to further expand our business and extend our reach into complementary markets. By extending our leadership position in the broader Service Assurance and Cyber Security markets, we will move forward with a clear focus on fulfilling the responsibility associated with our new tag line and mission, called "Guardians of the Connected World."

More than two decades ago, NetScout pioneered the "network traffic-based" approach, for 7x24, continuous monitoring of the end-user experience, as a unique technique to reduce the many tangible risks associated with downtime and poor service quality. In today's increasingly "connected world," the expectation in every facet of our personal and professional lives is that we can access all of our applications, at any time and over a wide range of devices from PCs and laptops to cell phones and tablets. That is why the IT infrastructure must be "always on." As a result, we believe the relevance of our technology and our approach is more prominent than ever before.

All of the businesses that we are acquiring believe that the best source of data to solve problems is the traffic flowing over the network as it is indicative of actual communication. We all believe in the power of a traffic-based instrumentation approach and are actively selling analytics solutions in markets that extend beyond the traditional service assurance space where NetScout has been an innovator and market leader. These solutions span WiFi monitoring, business intelligence via customer experience management, radio access network optimization, and cyber security. As a result, we have more than doubled our total addressable market to over

$8 billion.

The range of solutions, talent and resources in the combined company will create tremendous platform synergies as well as notable cross-selling opportunities. We also expect to benefit from greater scale and a more strategic position within a larger and more global customer base in both the Service Provider and Enterprise segments of our business. We believe that these dynamics will, in turn, further enhance our ability to capitalize on this bigger TAM, produce impressive operating margin leverage and drive even more superior returns for our shareholders in the coming years

To realize our potential and deliver on our vision, we plan to stay focused on meeting our customers' dynamic needs from a development, sales and marketing, and support perspective. Our strategic direction is clear; we believe we are in a unique position to enable our customers to realize the power of traffic-based instrumentation to address their service assurance and cyber security requirements. Having spent time at several major offices of the acquired companies shortly after closing the transaction, we were pleased to see that our new colleagues share our sense of excitement and enthusiasm about NetScout's future.

The teams responsible for bringing our company together have focused their initial efforts on the day 1 readiness required to continue meeting our customers' requirements, smoothly transition over 2,000 employees into our company and support our financial reporting activities. We have organized the company around multiple business units, while consolidating a bulk of the sales organizations under the leadership of our senior VP of worldwide sales. All of the Business Unit Leaders and the Sales Leader will report directly to me. From a development perspective, the engineering teams will continue to advance the roadmaps for their respective business units. At the same time, we see attractive opportunities to deliver unique value to our customers by integrating some of the technologies from multiple business units. Our teams have already been meeting to advance this development initiative and we plan to bring some of these offerings to the marketplace later this year.

While it is only two weeks into operating as a combined company, we have hit the ground running. We have many meetings lined up with our largest and most strategic accounts in order to walk them through our roadmaps and better understand how those roadmaps can align to their near-term and longer-term project requirements. We currently see a number of significant opportunities ahead. However, our visibility into the precise timing of some of these projects remains somewhat limited, especially given the timing of the acquisition. Related to this, we plan to carefully manage the cost structure of our business as we advance our integration activities.

Moving on to NetScout's first-quarter performance, we continued to execute and stayed focus on addressing our customers' requirements. We reported first-quarter revenue of 100.7 million dollars, which is a decline of seven percent from the same period one year ago. This was within the guidance range that we provided, as we lapped a particularly strong quarter. As a reminder, last year's first-quarter revenue benefited from the activity of one of NetScout's tier-one service provider customers who has a purchasing pattern of placing one large order to support deployment plans that span multiple quarters. During the first quarter, we also remained disciplined with respect to the expense, even as we continued to direct prudent investment into major development and sales initiatives, including the acceleration of certain marketing activities to support our branding and broader go-to-market campaigns, including our annual Engage user conference in April. As a result, we reported non-GAAP EPS of thirty three cents per diluted share, down eight percent from the year ago quarter.

We were generally pleased with demand levels in the quarter from our service provider customers. We've continued to see our service providers customers in key markets around the world turn to NetScout to support the build out and expansion of their 4G/LTE networks, and deliver high-value services such as voice over LTE calling. Just as important, the drivers behind these infrastructure investments remain robust.

For our enterprise and government customers, we experienced good growth as these customers continue to select nGeniusONE as their solution platform. Jean will provide some additional detail in a few moments. We believe that we are well positioned to drive improved performance in these markets as we leverage the initial adoption of nGeniusONE that's occurred since its launch two years ago. We expect to bring new features and functionality to the marketplace over the coming months, including 100-gig capacity and new modules to further automate the service triage process, as well as deliver integrated support and innovative go-to-market programs for customers advancing virtualization initiatives. Additionally, we will go-to-market with a broader range of offerings via the Fluke capabilities and the Arbor cyber security platform. We'll be developing and implementing those cross-selling campaigns as we move into the second half of the year.

I'd like to conclude by thanking the more than 3,000-strong individuals who are part of the NetScout team for the efforts to date. I am confident that we have the people, products, partners and programs in place to make fiscal year 2016 very successful and those efforts will set the stage for further improvement over the longer term. As many of you know, we are planning to be in New York next week where we will ring the opening bell at Nasdaq and host an Investor Day event. At the Investor Day, we will plan to provide additional insight into the combined company's strategy, value proposition, growth opportunities and financial profile. I look forward to seeing you at this event or having you listen to it through the webcast.

With that said, I will now turn the call over to Michael.

Michael Szabados:

Thank you, Anil.

It is a very exciting time for NetScout. Having spent considerable time with the teams from NetScout, Tektronix Communications, Arbor Networks, VSS Monitoring and Fluke Networks since closing the acquisition, we see great enthusiasm for what we can accomplish together. The opportunity in front of our Company is a significant one and we move forward with a value proposition that we believe will be uniquely compelling to hundreds of service providers and more than ten thousand enterprise customers around the world. I'd like to review a couple of recent success stories for NetScout as they should be helpful to you as you think about our potential to leverage the combined capabilities of our post-acquisition company across a larger, more diverse and more global customer base.

Last month, we announced that Open Mobile, a leading network operator offering a complete range of Internet and mobile cellular services exclusively in Puerto Rico, selected NetScout to ensure service delivery and provide operational intelligence support for its wireless network. Although the incumbent vendor competed aggressively to win this business, NetScout was chosen based on the strength of our proven workflows that offered deeper insight into their LTE network. NetScout's solution includes our nGeniusONE management system, InfiniStream Appliances and Packet Flow Switches for traffic aggregation and distribution. We see potential to deliver further value in the future to this customer, as we will have a broader range of capabilities and offerings that can help us extend our footprint within this and other accounts.

One win I'd highlight in the financial services vertical is a leading diversified insurance and financial services provider with a nationwide footprint. This firm has rolled out NetScout's nGeniusONE to assure the connectivity and quality of the firm's unified communications infrastructure as well as support a new data center build out. The workflows of nGeniusONE continue to distinguish and differentiate NetScout, providing this customer with timely, high-value insight into key performance indicators that can help them to quickly identify and triage the root causes of issues impacting the network and UC service applications.

Within our government customers, I'd like to spotlight a couple of wins as I think they are illustrative of the ways that we will continue to grow and bring value to public sector customers. During the first quarter, we secured a multi-million dollar deployment with a major arm of the U.S. military. This customer was experiencing major issues associated with its packet transmission across its network, creating frequent network disruptions that required considerable time and resources to identify and remediate. They selected nGeniusONE due to the real-time agility of our ASI technology that can enable them to use our nGeniusONE dashboards to help them quickly isolate and identify issues impacting performance. Having already deployed NetScout as a troubleshooting and reporting platform in its major non-classified sites, this deployment also extends our reach into across classified and secondary sites. Just as important, they are planning to instrument server farms within their broader IT infrastructure in order to benefit from the service triage capabilities of nGeniusONE.

Turning toward the initial nGeniusONE adoption, we continue to see the follow-on benefits from the product's launch. As we have migrated various features and functionality from predecessor platforms, a process that we completed this past spring, we have seen customers begin broadening their use of nGeniusONE. Last quarter, a large defense agency commenced a multi-million dollar transition from our legacy Performance Manager software and older generation probes to the nGeniusONE-InfiniStream solution that also will support continuous monitoring of select applications and provide better insight into their global enterprise infrastructure. The nGeniusONE dashboard will be used by multiple departments spanning engineering, operations and security, helping them to rapidly identify and resolve issues that affect overall productivity and effectiveness while improving the reporting that is provided to their executive management.

We are optimistic about our ability to drive strong performance in the enterprise. NetScout's capabilities will be complemented by the acquired Fluke set of offerings, which range from portable network analysis and troubleshooting tools to network and application performance management solutions for mid-tier enterprise customers and industrial-grade wifi monitoring solutions that help customers design, analyze and protect their wireless infrastructure. Our enterprise opportunities with our packet flow switch will be further enhanced with the addition of the VSS Monitoring solutions. In addition, the Arbor team brings unparalleled expertise in the cyber security market as a leader in DDOS identification and mitigation solutions. As Arbor looks to expand further into the enterprise market, we look forward to collaborating with them in terms of both cross-selling and product development.

NetScout has a tremendous opportunity ahead as we bring together the different businesses and leverage what we believe will be a very powerful platform. In becoming a more strategic partner to a wider range of customers worldwide, we will look to drive greater market awareness of the different ways that we can help customers thrive in the connected world. Looking ahead, there is a wide range of events around the globe that our teams will be participating in to promote our capabilities to both current and prospective customers in our service provider and enterprise segments.

That concludes my remarks at this point; I'll turn it over to Jean for the financial review.

Slide 6: CFO Review

Jean Bua:

Thank you Michael and good morning everyone.

This morning, I will plan to review key metrics for the first quarter, and then I will discuss our guidance for the upcoming fiscal year. As mentioned at the outset, we will be referencing non-GAAP metrics when appropriate, and comparing all figures against the comparable prior year period unless otherwise noted.

Slide 7: Q1 FY 2016 Income Statement

To begin our financial discussion, we will be starting with slide number 7 of our presentation which is accompanying this call. As a reminder, it is posted on our website.

For our first fiscal quarter, total revenue was 100.7 million dollars which is a decline of 7 percent from the same quarter in fiscal year 2015. The decline was led by a 17% decrease in product revenue as the result of an exceptionally strong Q1 of the prior year, which was led by one of our large Tier-1 service provider customers who purchased in the comparable quarter of last year in order to support one of their large multi-quarter deployments.

Service revenue was $47.1 million dollars and represented an 8% increase over the prior year's quarter.

Gross profit was 80.7 million dollars. Our gross margin percentage for the quarter was 80.1 percent which is relatively in line with the gross margin percentage of the prior year's quarter.

Operating income for the quarter was 21.9 million dollars with a 21.8 percent operating income margin. Due to the higher product revenue experienced in last year's quarter, the comparable period's operating margin last year was 23.4%

For the first quarter, we reported net income of 13.7 million dollars, or 33 cents per diluted share. The net income margin was 13.6 percent as compared to the prior year's quarter of 14.1%

Slide 8: Q1 FY 2016 Product Revenue Composition

Slide 8 provides detail on our product revenue composition for the first quarter. As we move forward under the combined businesses, we are consolidating the Enterprise and Government vertical since the government vertical will no longer be as material to understanding the revenue performance of the business.

The components of our 53.6 million dollars of **Product Revenue** in the first quarter of fiscal year 2016 were in line with our historical composition where Service Provider was 40% and Enterprise was 60%

Slide 9: Q1 FY 2016 Product Revenue Growth by Sector

Slide 9 illustrates our product revenue growth rates for fiscal year 2016 by vertical.

The Enterprise vertical grew 42% primarily as a result of significant growth coming from the government sector. As Michael noted, multiple agencies have selected nGeniusONE as their platform to optimize the performance of their networks and the broader IT infrastructure as they transition from a troubleshooting environment to proactive service assurance. We also experienced growth in our high tech, manufacturing and entertainment sectors. The financial services industry was down slightly for the quarter.

Our service provider product revenue declined by a little less than half from the year ago quarter. As we've noted, last year's first quarter saw a spike in demand by certain service provider customers with one North American carrier in particular who placed a substantial order to support deployment of our products over a multi-quarter period. Additionally, we also moved quickly to meet the fast turnaround demands of another service provider late in the quarter.

Slide 10: Q1 FY 2016 Total Revenue Composition

Slide 10 shows our Total Revenue Composition for the first quarter of fiscal year 2016.

The composition of our 100.7 million dollars of Total Revenue for the first quarter was as follows:

- Our Enterprise customers represented 64.2 million dollars, or 64 percent of total revenue and
- Service Providers generated 36.5 million dollars, or 36 percent of total revenue.

Going forward, we expect that the revenue mix in future quarters will be oriented toward service provider customers since Tektronix Communications was nearly 100% service provider and the majority of revenue at Arbor Networks also came from this vertical. We expect that service provider will be approximately 60% of total quarterly revenue, depending on the timing and magnitude of certain projects.

Slide 11: Q1 FY 2016 Total Revenue Growth by Sector

Turning to Slide 11 … This depicts our total revenue growth by sector for the first quarter.

Total revenue for enterprise grew 24 percent with strong performances within the government, high tech, manufacturing and entertainment sectors as I mentioned previously. This progress was offset by the decline in total revenue in our service provider vertical.

Slide 12: Q1 FY 2016 Total Revenue by Geography

Let's turn to slide 12 for a review of our revenue by geographic region in the first quarter of fiscal year 2016.

The quarterly revenue mix was 78 percent domestic and 22 percent international. As Anil mentioned, we expect that the international piece of our business will expand to approximately one third of our revenue coming from outside of North America.

Within our international revenue, Europe represented 13 percent of revenue with 3 percent for Asia and 6 percent for the rest of the world. Europe's growth rate is the result of demand from a tier-one service provider in this region.

Slide 13: Balance Sheet Highlights & Free Cash Flow

Slide 13 details our balance sheet highlights and free cash flow.

We continued to maintain strong liquidity through the first quarter. At the end of June, we had invested cash, short term marketable securities and long-term marketable securities of 267.5 million dollars. As you know, we put a new, 5-year 800 million dollar senior secured revolving credit facility in place with the closing of the transaction. This replaces our previous 250 million dollar facility, and can be drawn to support the general working capital requirements consistent with operating a larger company as well as to repurchase common stock under the Company's new 20 million share common stock repurchase plan. The combination of our current cash position plus the credit facility provides us with nearly 1.1 billion of total liquidity.

Our first-quarter fiscal year 2016 free cash flow was 5.8 million dollars. This reflects 9.3 million dollars in cash flow from operations less 3.5 million dollars in capital expenditures and the purchase of intangible assets. The decrease is attributable to the lower net income combined with changes in working capital, most notably the payment of variable incentive compensation earned throughout fiscal year 2015 and professional fees associated with the transaction.

Accounts receivable net of allowances was 58.5 million dollars, down from 82.2 million dollars at the end of fiscal year 2015. Days sales outstanding were 51 days for the quarter, which was a decline of 10 days from the DSO level last quarter, although it is higher than the exceptionally low mark of 26 days we reported in the first quarter of last year.

Inventories were 12.7 million dollars. This is up by 600 thousand dollars since the March year end.

Our total deferred revenue was 136.1 million dollars, which declined by 14.3 million dollars against the year-end fiscal 2015 balance. This decline is consistent with the historical pattern we've seen with lower levels of renewals in the first half of our fiscal year.

Related to our share repurchase program, we repurchased a total of sixty seven thousand, seven hundred and fifty two (67,752) shares in the first quarter, at an average price of $41.12 per share, totaling approximately $2.8 million. These repurchases were made under our previous 100 million dollar repurchase program. When the Danaher's tender offer began, we were precluded from transacting in our own shares and ceased buying in the open market. Upon the completion of the transaction, we replaced the $100 million dollar share repurchase program with our current20 million share repurchase plan. Additionally, we created a 10b5-1 plan in order to begin repurchasing shares after the transaction closed on July 14th. We have been active in the market in the days following the transaction's completion with open market purchases under this 10b5-1 plan. We expect our repurchasing activity to continue via the 10b5-1 plan as we move through the second fiscal quarter.

Slides 14 and 15: Guidance – FY 2016

Let's turn to our guidance for fiscal year 2016 on Slide14.

With the acquisition of Danaher's Communications Business now complete, we are in a position to offer guidance for the balance of fiscal year 2016. Our non-GAAP revenue guidance for fiscal year 2016 ranges from one billion and fifty million dollars to 1.1 billion dollars. Our non-GAAP earnings per share guidance ranges from $1.80 to $1.95.

With the close of the acquisition, the complexity of our business and financial activities has increased. As such, on a go-forward basis, we will discuss our performance in light of certain items including foreign currency exchange rates, outstanding share count, and debt levels. Additionally, there are a few moving pieces as we integrate the operations over the coming quarters. These include existing transitional support agreements with Danaher, transfer of certain businesses in foreign jurisdictions, and duplicative costs associated with staffing as we transition from these support agreements. As such, we will note any one-time effects in our performance. Consistent with explaining our performance, we would also like to shape the upcoming quarter and the activity associated with it.

As such, I would like to provide some thoughts on how we view our second quarter performance. At this time, we believe that the second-quarter revenue will contribute between roughly 25 to 27 percent of the full year revenue guidance range. We are in the execution phase of a significant and exciting project with one of our Tier-1 service providers. While we are in the end stages of executing this project with our customer, the recording of the associated revenue is predicated on receiving documentation from the customer acknowledging the project's completion. We currently anticipate that this documentation will be obtained close to the end of September.

Earnings per share for the second quarter should contribute about 16 to 18 percent of our full year earnings per share guidance range. With regard to the tax rate for our second quarter, we anticipate a tax rate in the 45 to 47 percent range. This is due to the expensing of certain deal-related costs such as professional fees that are not deductible for tax purposes. We anticipate that the overall tax rate will modulate for the remainder of the year and will range from 36 to 38 percent for the entire fiscal year 2016. The higher tax rate is due to the expiration of the research and development tax credit which expired at the end of calendar year 2014 and the aforementioned deal costs. As is our past practice, if and when the R&D tax credit is reinstated, we will note it in our earnings per share performance and adjust our go-forward earnings per share guidance ranges accordingly.

Looking ahead into fiscal year 2017, we believe we are on the path toward achieving our goals for the first full year of operations and positioning the Company for continued revenue growth and expanding operating margins, cash flow and earnings per share.

The closing of our acquisition of the Danaher Communications business opens a new chapter for NetScout. Our market capitalization has increased from about $1.6 billion to almost $4 billion, and as such, we transitioned from the S&P 600 small cap index to the S&P 400 mid cap index. Consistent with the tone and tenor of Anil's commentary, we are very excited about NetScout's future and see substantial opportunity to create significant shareholder value over the long term. I would also like to thank our shareholders for supporting this transaction and the tender offer, and welcome continuing dialogue with both our existing and new shareholders.

We are looking forward to hosting our Investor Day next Tuesday, August 4th where we will share more color on our performance as we execute our current five-year strategy. As a reminder before I wrap up our prepared remarks, in addition to our Investor Day, we plan to participate at several investor conferences over the next two months, namely:

- We will be presenting at the Needham & Company's Interconnect Conference on August 5 in New York;
- We will be participating at the Oppenheimer & Company Technology, Internet & Communications Conference on August 12 in Boston;
- In September, we will be at the Credit Suisse Small & Mid-Cap Conference on September 16 in New York followed by the Deutsche Bank Technology Conference on September 17 in Las Vegas.

That concludes our prepared remarks this morning. Thank you for joining us and we look forward to taking your questions.