NetScout Systems, Inc.
First-Quarter Fiscal Year 2017 Financial Results Conference Call
Management's Prepared Remarks

July 28, 2016

A. Kramer: Safe Harbor Statement and Other Details

Thank you and good morning everyone. Welcome to NetScout's fiscal year 2017 first-quarter conference call for the period ended June 30, 2016. 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 executive vice president and chief financial officer

We have included a slide presentation that accompanies our prepared remarks. For those dialing into the call this morning who would like to view the slides, 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 our commentary. We will try to remember to call out the slide number we are referencing in our remarks.

In terms of today's agenda, Anil Singhal will share his perspective on our first-quarter results and offer his perspective on some of our promising new product opportunities. Our COO Michael Szabados will review our integration progress, highlight some recent wins and recap notable go-to-market developments. Our CFO Jean Bua will then provide greater detail and insight into our financial results, and our guidance for fiscal year 2017.

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 conference call 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 conference call, which are not strictly historical statements, including without limitation, the statements related to the financial guidance and expectations for NetScout, market conditions and customer demand, and all of the other various product development, sales and marketing, expense management, integration and other initiatives planned for fiscal year 2017 and beyond, constitute forward-looking statements which involve risks and uncertainties. Actual results could differ materially from the forward-looking statements due to known and unknown risk, uncertainties, assumptions and other factors. Such factors are detailed on this slide and I strongly encourage you to review them. For an even more detailed description of the risk factors associated with the Company, please refer to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2016, which is on file with the Securities and Exchange Commission. NetScout assumes no obligation to update any forward-looking information contained in this communication 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. This slide also provides information about the use of GAAP and non-GAAP measures since non-GAAP measures are not intended to be superior to, or a substitute for, the equivalent GAAP metric. 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.

As a reminder, we recently passed the one-year anniversary of the completion of our acquisition of Danaher's Communications Business. The first quarter of fiscal year 2017 is the last full quarter in which the timing and magnitude of the acquisition skews period-to-period comparisons and potential discussions related to growth rates. To provide an "apples-to-apples" comparison between the first quarters of fiscal years 2016 and 2017, we will provide additional non-GAAP pro forma details so that you can better understand the recent performance trends as well as provide further context for our fiscal year 2017 guidance. Nevertheless, when we do note a growth rate, we will strive to clarify the nature of the comparison. Reconciliations between the GAAP and non-GAAP pro forma financials are provided at the end of the slide presentation.

As we detailed in our press release today, NetScout reported first-quarter results that came in ahead of our plans entering the quarter in terms of both revenue and EPS. As we move forward, we are executing well on our product development roadmaps and expect to bring a range of new and enhanced offerings to the marketplace over the coming quarters that integrate the technologies that came to NetScout from our acquisition of Danaher's Communications Business. With that as a high level background, I will turn the call over to Anil to provide some further context on our results and plans for the coming quarters. Anil, please go ahead.

Anil Singhal:

Thank you Andy. Good morning everybody and thank you for joining us today.

As Andy mentioned, I will first recap our results this quarter and then focus my comments on helping you better understand how our product roadmap can help us reinvigorate our top-line performance. There are several slides that will accompany my comments, so let's begin on slide number 5.

Slide #5: Q1 FY17 Performance

For the first quarter of fiscal year 2017, we generated revenue of 278 million dollars and diluted EPS of 28 cents, both of which were slightly ahead of our quarterly plans. This enabled us to generate solid free cash flow, which, in turn, helped support our repurchase of approximately 2.1 million shares of our common stock during the quarter.

As you know, the timing and magnitude of our acquisition of Danaher's Communications Business has skewed comparisons with NetScout's results in the prior fiscal year. The table on this slide provides a pro forma comparison of key metrics for the first quarter for fiscal years 2016 and 2017 with the first quarter of 2016 being presented as if the acquisition had been completed on April 1, 2015. Jean will provide a more detailed review of the pro forma performance later on the call, but I'll share several brief observations:

- In terms of our pro forma, non-GAAP performance, revenue grew 3.6 percent as we benefited from decent growth with our service provider customers. Within this customer segment, we enjoyed robust demand for our distributed denial of service (DDoS) cybersecurity solutions along with moderate service assurance growth. This helped offset a modest decline in our enterprise business, primarily arising from transitional challenges related to the acquisition.

- Our efforts to drive synergies related to the acquisition and control our cost structure enabled us to convert relatively modest revenue growth into a 34 percent increase in the combined company's pro forma non-GAAP income from operations. Our operating profit margin improved from 12.0 percent to 15.5 percent.
- While we have remained disciplined in managing costs, we are continuing to fund innovation in ways that we expect will yield tangible results as we enter a new product cycle. I will cover this in more detail momentarily.
- We remain in a very strong competitive position in our core markets. Although the service provider capital spending environment was muted during the first half of the calendar year, we did not see any signs of further deterioration during this past quarter, and we continued to win projects with both existing and new customers. In the enterprise, we've made good progress addressing the transitional issues affecting certain acquired product lines, and we are optimistic that our go-to-market plans for the remainder of the year will enhance our position in this area. We also continued to put distance between us and our competition in the DDoS market, and see exciting opportunities in the advanced threat market that we entered in early 2016.

Slide #6: Delivering Customer-Driven Innovation in FY '17

I'd like to provide greater context for the new product cycle that we are entering so let's move to slide number 6. As you may recall, we spent considerable time on last quarter's call detailing our strategy aimed at maximizing the Danaher Communications assets we acquired. At the foundation of our plans is our patented, proprietary Adaptive Service Intelligence (ASI) technology. Only ASI has the requisite scalability, real-time agility and flexibility to serve as the underlying technology for powering a suite of interconnected analytic solutions. We describe this approach internally as ASI-plus with the plus being integration of the technologies we gained from the acquisition, as well as opening up ASI to allow customers to self-configure nGeniusONE, ingesting other data sources, and facilitating easier data export. With these capabilities, we believe customers will gain an even broader, more holistic view into their network and application infrastructure, thereby simplifying the way that our customers manage their technology infrastructures, and helping them consolidate their supplier base.

Our product roadmaps are aimed at:

- Extending visibility from the core of our customers' networks to the edge
    - For service providers, that spans from the radio access network to their mobile core and for physical, virtual and hybrid environments;
    - For enterprises, that spans from their data centers to their cloud environments, regardless of whether that is private or public cloud;

Just as important, we plan to introduce new products and new capabilities that:

- Provide faster, more effective triage of issues impacting both custom and third-party applications, regardless of whether those apps reside in traditional data centers or in the public cloud;
- Support our customers across both wired and wireless networks;
- Complement our analysis of packet data with flow data and other machine data; and
- Move us into sizeable, growth-oriented adjacencies in cybersecurity and big data.

We believe that we have a tremendous opportunity ahead to fortify and expand our customer relationships as we bring new next-generation instrumentation and high-value analytics to the marketplace spanning service assurance, cybersecurity and big data. By unifying previously separate technologies, we can provide a broader platform that offers a "single pane of glass" for customers as they strive to enhance service delivery and deliver a high-quality user experience. With that in mind, I'd like to focus on two of these initiatives, one for our service providers and one for our enterprise customers.

Next-Generation Instrumentation

At our recent user forum, we unveiled our InfiniStream NG, which stands for next generation. For service providers, this new instrumentation platform combines support the best-in-class monitoring analytics from NetScout with the market-leading subscriber session trace capabilities from the former TekComms assets. We've designed the InfiniStream NG as a platform agnostic product, meaning that it can be sold as a traditional appliance; as software that can be added to commercial, off-the-shelf, or COTS, hardware that the customer procures; or to monitor virtualized network functions (NFV). We share the view of industry experts who expect that the transition to NFV will proceed gradually over the next five to ten years. As that transition occurs, it will create a hybrid infrastructure where we see opportunity to leverage our position as an incumbent monitoring platform for their physical networks by expanding the number of instrumentation points that we monitor. We further believe that we are well positioned to win new software-only opportunities with both service provider and enterprise customers, although we expect that the spend in this area will remain limited in the near term. Over the longer term, however, we believe that our software will be increasingly important in enabling customers to deploy our technology more pervasively while also increasing our flexibility to configure our solutions in ways that can appeal to a broader set of customers with varying technical and budgetary requirements.

We have been shipping the InfiniStream NG to our service provider customers with support for the NetScout analytics since the Fall of 2015 and the support for the TekComms analytics covering all of the latest network technologies is now generally available.

Just as critical, our NG appliance will leverage NetScout's technology architecture to deliver a product gross margin profile consistent with pre-acquisition NetScout. Accordingly, while it will take some time to drive adoption of the new platform into the installed base of Tektronix Communications customers, we believe that our success on this front will be instrumental in returning gross margins to their historical levels, with some benefits anticipated as we exit fiscal year 2017. We also plan to offer multiple software versions of the InfiniStream NG to address our customers' COTS, virtualization, and private and public cloud requirements.

Application Performance Management

In the enterprise, we believe that ASI-plus can help us gain more traction in the application performance management (APM) area. Our initial APM success with nGeniusONE involved facilitating faster, more effective service triage for leading third-party applications from Microsoft, Oracle, Citrix and dozens of other vendors. However, IT is increasingly being tasked to rapidly develop custom applications using standard, open source frameworks. While traditional APM tools can do a good job at troubleshooting code-level issues, problems often arise when those apps are launched into production environments where they must seamlessly interact with the broader infrastructure. We believe that NetScout's capabilities will be value-added and highly complementary with today's APM tools because our platform excels at quickly identifying infrastructure interdependencies that affect an application's performance in production environments. Later this summer, we plan to make our ASI technology available to DevOps teams so that they can very quickly and easily configure nGeniusONE for their custom applications, which will enable them to put those apps into production with greater confidence.

Over the coming months and quarters, we plan to more tightly integrate nGeniusONE with capabilities from the former FNET assets for wireless network analysis and troubleshooting, and we plan to augment our virtualized software solutions with FNET's tools for monitoring application availability and performance in public cloud environments via an active test sensor. We'll also bring out new modules for big data that both enterprises and service providers can use to further monetize the rich, timely traffic data we collect on their behalf. We are also excited about accelerating Arbor Networks' entry into the advanced threat market by complementing Arbor's timely, robust catalog of advanced threats with NetScout's insight into anomalistic behavior. We expect that integrated versions of each of these offerings will be re-introduced to customers over the course of fiscal year 2017, and we'll provide more insight into these development initiatives on future calls.

Slide #7: Outlook

Turning to slide number seven, we believe we are off to a good start for fiscal year 2017. Our outlook for fiscal year 2017 is fundamentally unchanged although aspects of our guidance were refined to reflect the quarter's share repurchase activity and certain assumptions for acquisition-related expenses. Jean will provide some further color on our outlook in a few minutes.

Nevertheless, we recognize that there is a lot of work left to do in order to achieve our targets in fiscal year 2017. Although we believe the service provider spending environment is likely to remain fluid in the near-term, we expect that our full-year revenue performance will be weighted toward the second half of the fiscal year, which would be consistent with historical trends. In cybersecurity, we see good opportunity to build on the momentum we've gained in recent quarters, and we anticipate stronger service assurance demand with both enterprise and service provider customers. Our view is based in large part on orders for certain projects that we've already received, and anticipated orders for projects where we have good visibility. In addition, we are just starting to build sales pipelines for the new products that we plan to bring into the marketplace over the coming months, although we believe it will take at least a couple of quarters for these initiatives to begin making a more substantial impact.

At the same time, we anticipate meaningful improvement in our operating margin during the second half of the fiscal year. To achieve this, we intend to continue vigilantly managing our cost structure and advancing acquisition-related synergies even as we fund this new product cycle and support our legacy products and technology platforms.

Finally, you may have noted that July 14 marked the one-year anniversary of our acquisition of Danaher's Communications Business. During this period, we have made good progress with our integration initiatives as well as talent retention, and I'd like thank my colleagues for their tenacity, commitment and hard work. As we look ahead, our team is very excited about the opportunities we see to help customers ensure that their infrastructures are "always on" for their end users, enabling them to deliver the high-quality applications and services that underpin our connected world. In fact, we are starting to see a number of similarities between how today's digital revolution has potential to act as a catalyst for demand and how key networking innovations helped drive rapid growth for NetScout in the 1990s. That concludes my remarks and I'll turn the call over to Michael at this point.

Slide 9: COO Highlights

Michael Szabados:

Thank you Anil and good morning everyone. Slide number 9 provides an overview of the areas I plan to cover. First, I'd like to briefly update you on our integration activity. Next, I will highlight some key customer wins that support some of Anil's commentary. I will close by sharing some highlights from our major sales events this past quarter.

As Anil noted, last week was the one-year milestone of the consummation of our acquisition of the Communications Business from Danaher. I am pleased that, by end of June, we wound down every significant transition services agreement with Danaher, and we plan to close out the last two smaller TSAs next month. Most notably, we completed the transition of order processing and fulfillment services, and manufacturing operations for the former FNET business, including the portable tools product lines. Critical to this transition, our Connect360 enterprise channel partner program has been up and running for over a quarter in support of the tools business. As a result, we are starting to see major partners for our tools offerings move forward with larger orders consistent with traditional restocking activity. As the next step in completing the integration, we've kicked off programs to align and integrate our business processes and IT systems with the legacy Tektronix Communications business, which we expect will extend through fiscal year 2017. Just as critical, retention of key talent and senior leaders has remained very high.

Wins / Use Cases

As Anil noted earlier, we have continued to win business with both new and existing customers.

In the service provider market, interest in our capabilities remains high although the spending environment has been choppy. Nevertheless, validating our overwhelming technology advantage, we regained traction with a tier-one North American provider over the past quarter who has returned to the combination of TekComms and NetScout solutions after trying, unsuccessfully, to source capability elsewhere. This customer placed a large, 8-figure order with us to help them ensure the quality of their VoLTE calls. This carrier has recognized that our ability to help them quickly and efficiently troubleshoot issues is increasingly important especially as overall traffic and the percentage of VoLTE calls on their network continues to grow. We anticipate additional orders from this customer in subsequent quarters this year.

In the enterprise, Anil noted our plans to realize product and customer synergies between NetScout and FNET. One prominent opportunity is to more tightly integrate nGeniusONE with the OptiView XG product. OptiView's portability, ease of use and robust WiFi troubleshooting capabilities already distinguish it in the marketplace. We believe that our enterprise customers are looking forward to this combination so that they can benefit from a consistent and cohesive view across their wired and wireless network infrastructures. This is best exemplified by a notable, six-figure XG order from a large U.S. energy delivery company that has already standardized on nGeniusONE in their data centers and major campuses. They plan to roll out our XGs for ad hoc troubleshooting, particularly as they use their high-speed wireless network in support of a smart metering initiative aimed at making its operations more efficient and to provide consumers with real-time insight that can help better manage their energy consumption.

Anil's remarks also touched on Arbor's success in extending its leadership in the DDoS market. During this past quarter, Arbor won a highly competitive deal at a North American, Tier-2 service provider who provides video, Internet and phone services to both residential and commercial customers. The customer is deploying Arbor's SP solution for comprehensive network visibility and reporting capabilities to help detect and understand availability threats, and improve traffic engineering, peering relationships and service performance. They are relying on one of Arbor's newest threat management systems, the TMS HD 1000, for up to 160 gigabits per second (Gbps) of surgical mitigation capacity in order to identify and remove DDoS attack traffic from the network without disrupting key network services.

Go to Market

In terms of go-to-market developments, we were extremely pleased with the record turnout and positive feedback from our annual user conference, Engage, held in May in Dallas. At this event, we briefed our enterprise and service provider customers on our service assurance and cybersecurity roadmaps, and their response to these plans was very enthusiastic. In addition, customers have raved about the latest release of nGeniusONE, which we view as another important step toward driving adoption of our solution and addressing new use cases and capturing a larger share of budgets within IT Operations.

Also of note, we participated earlier this month at Cisco Live, where we laid out our complete business assurance offering for the enterprise. Unique in the industry, NetScout defines business assurance as the combination of service assurance and cybersecurity, both of which are critical in successfully participating in the digital transformation sweeping our industry. It was a very productive show for NetScout and it has been gratifying to see how some of the largest equipment vendors are now adapting and amplifying NetScout's messages about the value and importance of network traffic intelligence, especially in the context of the software-defined data center and software defined network architectures.

This past quarter also saw prominent industry experts affirm NetScout's position as a market and technology leader. For example, in the packet flow switch area, which is also referred to as network visibility, IHS Infonetics recently ranked NetScout as the number one provider of these solutions to the service provider market.

I'll conclude by echoing Anil's sentiments about our enthusiasm for our path forward. I look forward to future calls when we can highlight new wins that validate the investments we are making to drive innovation and help assure the performance and security required to support and accelerate the digital transformation in our industry.

That concludes my prepared remarks and I will turn the call over to Jean.

Slide 10: CFO Review

Jean Bua:

Thank you Michael and good morning everyone.

This morning, I will plan to review key first quarter fiscal year 2017 metrics, and then I will review our guidance for the upcoming fiscal year. As we noted earlier, there were a number of acquisition-related items that impacted our GAAP results so our convention will be to refer to our non-GAAP results unless otherwise noted. On a related note, and consistent with our comments earlier on the call, the timing and magnitude of our acquisition of the Communications Business also impacts comparisons with the prior year period and any other extrapolations of our first-quarter results may not be representative. When possible, we will frame our results against prior periods on a pro forma basis. As noted earlier on the call, there is an appendix at the end of the slide presentation that provides a reconciliation of the non-GAAP pro forma financials, along with other supplemental detail.

Slide 11: Reported Q1 FY'17 Results v. Pro Forma Q1 FY'16 Results

To begin our financial discussion, we will be starting with slide number 11 of our presentation. I'll review our first-quarter performance with a focus on comparing it against pro forma FY '16 results, which assumes our acquisition of Danaher's Communications Business had been completed on April 1, 2015. Let's turn to slide 11 for this review. Please note that a reconciliation of the pro forma results is available in the appendix of these slides, and it is available for downloading on our website.

Revenue

For the first quarter of fiscal year 2017, total revenue was two hundred and seventy-eight ($278) million dollars, up 3.6 percent over the prior fiscal year's first quarter pro forma revenue. This was modestly ahead of our plan by more than one percent in part due to the acceleration of a few orders for certain projects that we had originally expected to receive in the second quarter.

Our revenue performance reflected low double-digit growth with our service provider customers due to exceptionally strong demand for our DDoS offerings and a mid-single digit increase for our service assurance solutions. This growth was partially offset by a modest mid-single digit decline in the enterprise primarily resulting from declines in the former Fluke systems and portable tools products. As Anil noted, we believe that the transitional issues affecting these product areas are largely behind us, although we believe it may take a few more quarters for certain product areas to gain momentum.

Product revenue was 168.8 million dollars, or 61 percent of total revenue during the past fiscal quarter. This was up 4.3 percent over the same quarter one year ago on a pro forma basis. Service revenue grew 2.7 percent to 109.1 million dollars, which represented 39 percent of total revenue.

In terms of other key revenue trends, our service provider segment represented 56 percent of total revenue with enterprise representing 44 percent. This is largely consistent with the prior year period. In terms of the geographic mix, which is calculated on a GAAP basis, we generated a higher percentage of international revenue than was the case for the prior year with 36 percent of total revenue coming from outside of the United States. This reflects the broader and more diverse geographic footprint resulting from the acquisition as well as the timing and magnitude of various projects for our service provider customer base around the world. This detail can be located in the appendix of the slides that accompany our remarks. We had one customer that represented greater than 10 percent of total revenue.

Gross Margin

In terms of profitability, our gross margin of 72.9 percent this quarter versus 73.4 percent one year ago on a pro forma basis reflected the overall product mix in the quarter. As Anil outlined, we expect that the launch of our InfiniStream NG platform will play an important role in improving gross margin over the longer term with some marginal benefit anticipated in the latter half of this fiscal year.

Operating Margin

Our operating margin in the first quarter of fiscal year 2017 was 15.5 percent, an improvement of 3.5 percentage points from 12.0 percent in 2016's first fiscal quarter on a pro forma basis. In addition to modestly higher revenue, we benefited from ongoing run-rate synergies and disciplined cost management. For example, as you know, the majority of our cost base is fixed with headcount being the largest single item. Overall, our headcount as of the quarter end was approximately 3,100, which is down 2 percent on a year-over-year basis. We've taken steps during the past year to realign and focus our sales, marketing and R&D teams, which have contributed to the headcount change as well as refined our marketing programs and tightened control of other discretionary expenses.

Net Income

For the first quarter, we reported net income of 26.3 million dollars, or 28 cents per diluted share. The net income margin was 9.5 percent. The overall impact from our share repurchase activity on earnings per share this quarter was less than half a penny.

Slide 12: Balance Sheet Highlights, Free Cash Flow and Share Repurchase

Slide 12 details our balance sheet highlights and free cash flow. We ended the quarter with cash, cash equivalents, short-term marketable securities and long-term marketable securities of 334.9 million dollars, which declined sequentially by 17.2 million dollars. During the quarter, we used our cash and free cash flow to fund our share repurchase activity. At the end of the quarter, we had 500 million dollars of available credit on our existing facility, which leaves us with total liquidity of nearly 835 million dollars. As you can see from this slide, our current financial profile is generally in line with our targets.

Share Repurchase Activity

I'd like to quickly review our progress in returning capital to shareholders. NetScout repurchased approximately 2.1 million shares of common stock during the first fiscal quarter at an average price of 23 dollars and 81 cents ($23.81) per share, totaling approximately 50.0 million dollars in the aggregate. At present, we still have approximately 7.8 million shares remaining on the 20 million shares that the Board authorized for repurchase.

As a reminder, our capital deployment priorities are to maintain financial capacity to further invest in our product development, either through in-house development or through acquired technologies. We currently seek to distribute excess cash flow to our shareholders through share repurchase and we expect to remain active on the share repurchase front in the second quarter.

Free Cash Flow & Other Balance Sheet Highlights

From a cash flow perspective, we generated free cash flow of 28.2 million dollars. This primarily reflects positive changes in working capital. Given our guidance range, we still believe that fiscal year 2017 free cash flow should be between 85 to 95 percent of expected non-GAAP net income.

In terms of a brief recap of other balance sheet highlights, accounts receivable net of allowances was 196.2 million dollars, which was down by approximately 51 million dollars from the end of our fiscal year primarily as a result of the timing for service renewals. This dynamic, in combination with timing of orders and related collections, helped reduce days sales outstanding to 66 days compared with 80 days in the prior quarter.

Slide 13: FY 2017 Guidance

Let's move to slide 13 to review the guidance, which we updated to reflect our recent share repurchase activity and certain changes to acquisition-related costs and expenses.

Our non-GAAP revenue outlook is unchanged. We still anticipate revenue between 1.2

billion dollars and one billion, two hundred and fifty million dollars ($1.2 billion and $1.25 billion). In terms of net income per diluted share, we have updated our guidance to reflect the first quarter's share repurchase of 2.1 million shares. The EPS guidance range has increased by two cents and now ranges from one dollar and eighty seven cents ($1.87) to two dollars and twelve cents ($2.12) per diluted share. The EPS guidance still assumes an operating margin of approximately 23 percent to approximately 25 percent. We now assume the average shares outstanding will be approximately 93 million. To be clear, our earnings per share guidance range for fiscal year 2017 does not reflect the potential accretion from any future share repurchase activity. As is our practice, we will update the earnings per share guidance range based on the share repurchase activity.

I'd like to provide some further color into our revenue outlook. As a reminder, we are lapping last year's second quarter that was bolstered by a very large, fifty million dollar-plus ($50 million+) service provider project. Given the fluidity of the current macroeconomic and geopolitical environments, we are taking a fairly conservative near-term view on second-quarter revenue at this time. As we said on last quarter's earnings call, we believe that our first-half revenue for fiscal year 2017 will be relatively flat with the prior fiscal year's first-half pro forma revenue. This is expected to result in a revenue skew with about 45 to 46 percent for the first half of the year using the mid-point of fiscal year 2017 guidance. We could see a positive fluctuation from this percentage as we have a strong pipeline in our federal government vertical and in the service provider segment but some of these potential orders are dependent on funding processes which have limited visibility right now.

Costs and Other Assumptions

From an expense perspective, our second-quarter operating costs should see a modest decline from first-quarter levels primarily due to the timing of our sales events last quarter and synergies related to the wind-down of various TSAs. Consequently, we anticipate our second-quarter operating margin to improve sequentially from our first-quarter operating margin and be in the upper teens.

In terms of other modeling assumptions for our earnings per share guidance. Based on 300 million dollars in draw downs on our credit facility, we expect interest expense of approximately 2.5 million dollars per quarter and a tax rate in the range of 34.5 to 35 percent. Based on less than 93 million shares outstanding for the second quarter, this would translate into a diluted EPS in the mid 30-cent range for the second quarter of fiscal year 2017.

That concludes my formal review of our financial results. Before we transition to Q&A, I'd like to outline our calendar for the upcoming various investor conferences that we will attend.

- We will participate in a Drexel Hamilton TMT event in New York on September 8;
- We are also planning to present at Deutsche Bank's Technology Conference in Las Vegas on September 13 and the Credit Suisse SMID Conference in New York on September 14; and
- Additionally, we're planning to augment these conference with outreach to our shareholders and prospects in New York and Boston, among other money centers.

That concludes our prepared remarks this morning. Thank you again for joining us and we're now ready to answer questions. Operator, you may now begin the Q&A session.