**NETSCOUT SYSTEMS, INC.**
**Second-Quarter Fiscal Year 2018 Financial Results Conference Call**
**Management's Prepared Remarks**

**October 26, 2017**

**A. Kramer: Introduction**

Thank you [operator] and good morning everyone. Welcome to NETSCOUT'S second-quarter fiscal year 2018 conference call for the period ended September 30, 2017. Joining me today 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

There is a slide presentation that accompanies our prepared remarks, both of which can be accessed on the investor relations section of our website at www.netscout.com. The slides can be advanced in the webcast viewer to follow our commentary. We will call out the slide number we are referencing in our remarks.

Today's agenda will be consistent with prior quarters. Anil Singhal, our president and CEO, will review our performance and major highlights. Our COO Michael Szabados will briefly discuss key wins and go-to-market developments. Our CFO Jean Bua will then review our second-quarter results and our fiscal year 2018 guidance.

**Slide #3: Safe Harbor Statement**

Moving on to slide #3, I would like to remind everybody listening that forward-looking statements as part of this communication 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 but not limited to, the statements related to the financial guidance and expectations for NETSCOUT, share repurchase activity, market conditions and customer demand, anticipated revenue from specific customers and specific products, along with all of the other various product development, sales and marketing, expense management and other initiatives planned for fiscal year 2018 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. This slide details these factors, and I strongly encourage you to review each of them. For a more detailed description of the Company's risk factors, please refer to the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2017 and the subsequent Quarterly Report on Form 10-Q, which are 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.

**Slide #4: Non-GAAP Reconciliation**

Let's turn to slide number 4, which involves non-GAAP metrics. While this 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, which we also encourage you to read, provides information about the use of GAAP and non-GAAP measures because 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 those and other reconciliations and supplemental detail are included at the end of the slide presentation, which is available on our website.

As we detailed in our press release today, our second-quarter results came in ahead of our expectations entering the quarter. We've continued to innovate and make further progress on our product roadmaps. We move into the second half of the year focused on addressing the challenges that lie ahead and capitalizing on the opportunities we see. With that as the high-level background, I will now turn the call over to Anil. Anil ...

**Anil Singhal:**

Thank you, Andy. Good morning everybody and thank you for joining us. Let's begin on slide 6 with a recap of our non-GAAP results.

**Slide #6: Q2 & 1H FY'18 Highlights**

NETSCOUT's second-quarter performance exceeded our plans entering the quarter with revenue coming in at 259.9 million dollars, a gross margin of 75.5 percent, an operating profit margin of 16.3 percent and diluted EPS of 29 cents per share.

Jean will review our performance in more detail, but I will share a few observations:

- Our quarterly revenue exceeded our plans for the quarter due largely to certain service provider orders that were previously expected for the third quarter and accelerated into the second quarter. While revenue was higher than we anticipated, it declined by 8 percent from the same quarter in the prior year in part due to the ongoing moderation in spending by one of our large tier-one customers.
- Our gross margin improved by a full percentage point primarily as a result of favorable shifts in product mix as we continue to make progress with our software-driven product strategy.
- In terms of our profitability, we've continued to prudently manage our costs even while funding a range of development activities that we believe will play a critical role in our long-term growth and success.
- On the new product front, we continued to make important progress with our efforts to innovate and expand our product portfolio and capabilities. Let's move to slide #7 to cover that in more detail.

**Slide #7: "Smart Data" Strategy and Product Development Highlights**

As we've discussed, our approach to collecting and analyzing network traffic or wire data is differentiated by our patented Adaptive Service Intelligence (ASI) technology, which instantly converts high-volume network traffic at the collection point into highly structured, multi-dimensional metadata or what we call "smart data." We are using this "smart data" to power an expanding range of analytics that address a growing number of use cases.

At the foundation of our "smart data" strategy is our real-time information platform, the ISNG, which offers deployment options that range from traditional appliance to software only. We introduced this platform last fall and we're making excellent progress in driving adoption of this platform in the software form factor with our service provider customers. Later on in the call, Michael will highlight how one of our cable MSO customers is deploying our ISNG software to monitor their expansive WiFi infrastructure. While the majority of the ISNG deals we are striking are for one-time, perpetual software licenses, a number of international carriers of varying sizes are now advancing discussions for multi-year, enterprise license agreements. The software-only version of our ISNG was approximately 10 percent of our second-quarter product revenue, up from the low single digits in the first quarter. This progress reinforces our confidence that this platform will represent between 8 to 10 percent of total product revenue in fiscal year 2018 and help drive notable improvement in our gross margins this year.

We have executed well on our product roadmaps to augment our new ISNG platform. Last quarter, we unveiled new, complementary instrumentation options and new analytics that extend visibility and enable deeper, more flexible and comprehensive analysis of both wire and non-wire data to support our customers' network performance, application performance, infrastructure performance, cybersecurity and big data requirements. These new offerings are intended to expand our total addressable market and elevate our value proposition as we help our customers monitor virtualized network functions, ensure application performance across both conventional IT data centers and private and public cloud environments, identify the root cause of infrastructure issues that impact the end user experience, and detect advanced security threats. We've been pleased with the growing interest in these offerings from both existing customers and prospects.

During this past quarter, we continued to innovate. In July, we announced the integration between our ISNG and the Arbor Spectrum analytics for network threat analysis, which enables network and security operations teams to each benefit from access to network traffic as its data source. Earlier this summer, as part of our plan to further differentiate Arbor Spectrum, we acquired Efflux Systems, which brings us a small but extremely talented engineering team with deep security and machine learning expertise. Over the coming quarters, we plan to integrate their technology and capabilities into our advanced threat offerings in ways that can support faster, more accurate and insightful detection of threat actor behavior.

In September, we formally introduced our nGenius Business Analytics, which makes wired data consumable for Big Data applications in a scalable, cost-effective manner. The product is already being used by more than a dozen service providers to help them automate operations, enhance customer care and deliver personalized services.

Similar to how we've decoupled our ISNG software from the appliance itself, we are doing the same for our network packet broker product line. Earlier this month, we announced the availability of the nGenius® Packet Flow eXtender, or PFX, software for service assurance and cybersecurity monitoring. The disaggregation of software-driven packet broker functionality from the underlying hardware is unique in the industry and disrupts how traditional packet brokers using proprietary hardware have been priced and licensed. We believe that this will enhance our ability to compete in an increasingly price-sensitive market, particularly for smaller and mid-sized enterprise accounts.

As a result of our progress in bringing our newest offerings and capabilities to the marketplace, we are nearing the end of our latest product cycle. We move into the second half of the year having made good progress across multiple fronts during the first six months of fiscal year 2018. This brings us to our outlook, which is covered on slide 8.

**Slide #8: Outlook**

Entering into fiscal year 2018, we set our top-line target at around 1.2 billion dollars, recognizing that keeping revenue relatively unchanged against the prior year would be an ambitious goal since our largest tier-one service provider customer was continuing to significantly moderate their 4G-related spending. We continue to expect that this customer's year-over-year decline in spending with us could be up to 100 million dollars. Our plan, at the beginning of this fiscal year, was to offset this decline through a combination of growth in other Tier-1 service provider accounts and by expanding our enterprise business. While our results to date are slightly ahead of our original expectations, we do see some challenges ahead in the second half.

In particular, the service provider spending environment remains under pressure and this is likely to continue influencing the timing and magnitude of larger service assurance and security purchases at many of our largest service provider customers. We are also concerned that carrier spending activity in North America could be further compromised by potential M&A activity. In the enterprise customer segment, second-quarter orders from the government vertical were not as strong as we originally anticipated, and it is unclear which projects, if any, that went unfunded last quarter will move forward during the second half of this fiscal year. For these reasons, we are taking a more conservative view into the third quarter.

Although these dynamics make it more challenging to fill the revenue gap created by the anticipated decline in spending at our largest tier-one customer, we have left our non-GAAP revenue and EPS guidance for the year unchanged. We continue to focus on mitigating the potential risks that we see through a variety of sales programs that are aimed at realizing potential upside opportunities from across our customer base over the next five months. As we have demonstrated consistently over the years, delivering on our EPS targets continues to be our top priority and if necessary, we are prepared to take certain actions to adjust our cost structure and preserve our EPS performance to the greatest extent possible.

In closing, we remain confident about our strategic direction and in our ability to deliver tangible value to all of our customers, employees and shareholders over the long term. We are seeing steady adoption of our new real-time information platform across our expansive service provider customer base. Our newest enterprise products are amplifying our value proposition to make us an even more strategic, valuable and trusted partner to our customers. Our DDoS solutions remain best-in-class and we've expanded our security offerings to help customers address advanced security threats. Consistent with this perspective, the Board authorized a new 25 million share repurchase program that provides us with the scope to further optimize our capital structure as we move forward. We will give due consideration to the timing, magnitude and approach to our buyback activity, particularly as we achieve greater visibility on the issues that could impact our near-term results. That concludes my prepared remarks and I'll turn the call over to Michael at this point.

**Slide 10: COO Highlights**

**Michael Szabados:**

Thank you Anil and good morning everyone. Slide number 10 outlines the areas that I will cover.

***Wins / Use Cases:***

As we've discussed on prior calls, a top priority in fiscal year 2018 is to fortify our incumbency with service providers by driving adoption of our software-only platform. We're continuing to make good progress on this front. This morning, I'd like to cover a new ISNG software win at a major North American cable MSO.

Over the years, this customer has used our traditional solutions to monitor voice applications, programming guide activity across set-top boxes and mobile apps, and WiFi connectivity. WiFi is a strategic area for this customer, particularly as it seeks to continue promoting this offering to its expansive subscriber base as well as market new, high-quality mobile calling services for which it can cost-effectively offload mobile traffic to the existing WiFi infrastructure. However, tight budgets had limited the customer's WiFi monitoring to only its largest markets. Given these dynamics, our ISNG software played perfectly into the customer's plans, and it has freed up well over five million dollars to fund the roll out of our software across the remaining markets over the next couple of quarters. In addition, this customer is also one of the dozen-plus accounts that has started to deploy our nGenius Business Analytics. This cable provider plans to use these capabilities in conjunction with our ISNG to enhance visibility into its network infrastructure, thereby further enriching the key data sets that should ultimately help it make better business decisions and improve the customer experience.

In the enterprise, we are starting to generate additional traction with our new vSCOUT and vSTREAM offerings that we introduced last quarter. These offerings provide enterprises with deeper application visibility, regardless of whether those apps run in a traditional data center or in the various forms of the cloud. We believe that these new products will ultimately bring us into new areas of the IT organization and enable us to tap into new budgets that were previously quite difficult for us to access. During the second quarter, a large civil service agency selected and began deploying vSCOUT in conjunction with NETSCOUT's traditional solutions to ensure that key applications operate with peak performance for both internal users and public customers. More specifically, vSCOUT will provide visibility into its critical applications running in virtual environments on Linux and Windows servers where the agency was previously blind to issues. This deal, which was valued in in the high six figures, further illustrates the flexibility of our technology to help our customers enhance their ability to deliver high-quality applications and quickly identify and triage issues that arise.

In security, Arbor enjoyed another strong quarter of enterprise growth. This quarter, Arbor secured a four million dollar DDoS order from a blue chip U.S. financial services company to refresh and expand its existing deployment of Arbor TMS, our inline DDoS attack mitigation solution. Arbor TMS is the most broadly deployed mitigation solution in the market due to its strength in filtering traffic in real-time, thereby allowing business services to remain available even while a DDoS attack is being mitigated. Over the past year, Arbor has made significant investments in the TMS platform, increasing its mitigation capacity from 40 gigabits per second to 100 gigabits per second while at the same time significantly improving the overall total cost of ownership. The new Arbor TMS solution has allowed this customer to substantially extend its deployment to cover more data centers around the globe. To further strengthen its reach with smaller and medium sized enterprises, Arbor recently announced a suite of new, affordable, flexible advanced DDoS protection options that range from on-premise appliances to virtualized solutions and Amazon Web Services support for unified protection across hybrid cloud environments.

***Go-to-Market Activity:***

As we move forward, we are very excited about the potential for our newest products as they move through the initial stages of their respective sales cycles. In addition to vSCOUT and vSTREAM, we are also pleased to see growing interest in our new nGeniusPulse offering as a highly complementary active testing and infrastructure performance monitoring capability to diagnose infrastructure performance issues impacting servers, routers, load balancers and other infrastructure equipment. We are investing in lead generation activities that will enable us to drive demand and raise greater awareness for these new offerings with both existing customers and prospects. For example, as the hybrid cloud continues to gain momentum across our customer base, we believe that our participation in events like last quarter's VMWorld and the upcoming AWS RE:INVENT conference will yield good returns. At the same time, the market continues to recognize our products as best-in-class. For example, during the past four weeks alone, our Arbor Cloud service received three significant awards for excellence in DDoS protection. I hope to share news of similar accolades for our newest products on future calls.

That concludes my prepared remarks and at this point, I will turn the call over to Jean.

**Slide 11: CFO Review**

**Jean Bua:**

Thank you Michael and good morning everyone. This morning, I will review key metrics for the second quarter and key revenue trends through the first six months of fiscal year 2018. After that, I'll review our fiscal year 2018 guidance. As a reminder, this review will focus on our non-GAAP results, and all reconciliations with our GAAP results are in the appendix of the slide presentation.

**Slide 12: Q2 FY'18 and 1H FY'18 Results**

Slide number 12 shows our results for the second quarter and first six months of fiscal year 2018. Focusing on our second-quarter results, total revenue decreased by 23.3 million dollars, or 8 percent, to 259.9 million dollars.

Our overall gross margin of 75.5 percent increased by approximately 100 basis points this quarter. This reflected good progress in improving product gross margins especially in light of a 25 million dollar decline in product revenue. This improvement primarily reflects favorable shifts in product mix due to ongoing progress with our product strategy that is aimed at replacing legacy hardware dependent offerings with our ASI software technology. Our operating expenses were essentially flat and our operating profit margin was 16.3 percent. This translated into diluted earnings per share of 29 cents.

**Slide 13: 1H FY'18 Revenue Trends: Customer Verticals & Geographic Mix**

Turning to Slide 13, I'd like to review key revenue trends.

As we've discussed on prior calls, we are managing through a significant moderation in purchasing by one of our large tier-one service provider customers following several years of elevated purchasing. We continue to expect fiscal year 2018 spending from this customer will decline by up to approximately 100 million dollars from the prior year. In the second quarter, this customer's spending declined by approximately 25 million dollars.

Within our service provider segment, overall revenue declined by 10 percent. The decline from that large tier-one customer was compounded by a mid-teens decrease in Arbor's service provider business as it lapped a tough comparable that was boosted by a product transition for one of its offerings. These declines were partially offset by 25 percent growth in all other service assurance service provider accounts.

Our enterprise vertical declined by roughly 6 percent in the second quarter. We saw strong revenue growth with Arbor's enterprise DDoS offerings. Revenue from the core NETSCOUT enterprise offerings declined modestly due to the government vertical not being as robust as we had expected. Additionally, we continued to see revenue declines in certain other ancillary product lines.

The composition of the first half's revenue reflected the decline in our service provider vertical and the mix was 52 percent of total revenue coming from service provider and 48 percent from enterprise.

In terms of revenue by geography, which is calculated on a GAAP basis, our first-half revenue in the United States declined due to the decrease in revenue from that large tier-one carrier while international revenue was relatively flat. International represented 39 percent of total first-half revenue versus 35 percent in last year's comparable period. We did not have a 10 percent revenue customer for either the second quarter or the first six months of the fiscal year.

**Slide 14: Balance Sheet Highlights, Free Cash Flow and Share Repurchase**

Slide 14 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 313.4 million dollars. During the second quarter, we used 100 million dollars to repurchase our stock. At the end of the second quarter, our revolver had 500 million dollars of available credit under the existing facility, which left us with total liquidity of nearly 815 million dollars. Our free cash flow for the second quarter of fiscal year 2018 was 13.9 million dollars and it was 63.2 million dollars for the first half of the year. We anticipate that our free cash flow for fiscal year 2018 will equate to approximately 100 percent of our non-GAAP net income.

***Share Repurchase Activity***

In terms of our share repurchase activity, we repurchased 3,022,355 (three million, twenty two thousand, three hundred and fifty five) shares of common stock at an average price of $33.09 (thirty three dollars and nine cents) per share, totaling approximately 100 million dollars in the aggregate. While this represented a negligible effect on the second quarter's earnings per share, our buyback activity for the first six months represents an incremental 7-cent increase to our earnings per share outlook for the year.

We ended the quarter with approximately 971 thousand shares remaining under our existing 20 million share repurchase authorization. As detailed in today's press release, the Board has authorized a new 25 million share repurchase program that will go into effect once we complete the existing program. We expect to be active in the market during this quarter.

To briefly recap other balance sheet highlights, accounts receivable, net, were 215.2 million dollars, down from the end of last year. DSOs were 72 days, an improvement from 80 days at the end of fiscal year 2017 and 80 days at the same time last year.

**Slide 15: FY 2018 Guidance**

Let's move to slide 15 for guidance. I will focus on the non-GAAP guidance and remind you that the reconciliation of our GAAP guidance to our non-GAAP guidance is in the appendix. This slide details our revenue and EPS targets for the year.

Earlier on the call, Anil detailed certain risks that we see in the second half of our fiscal year that may limit our ability to absorb the anticipated full-year decline in spending by our largest tier-one service provider customer and meet our annual revenue target. However, we are focused on advancing plans and tactics that will help mitigate those risks by accelerating and maximizing a range of opportunities across our customer base over the next five months. Accordingly, we have left our fiscal year 2018 guidance unchanged at this time.

***Q3 Revenue & EPS Outlook***

As Anil noted, we are taking a cautious view into the third quarter, and anticipate revenue in the range of 300 million dollars to 320 million dollars.

Other full-year modeling assumptions based on our outlook are outlined on this slide. Based on the quarterly impact of these assumptions, most notably relatively flat operating costs, and roughly 88.5 million diluted shares outstanding for the next two quarters, this would translate into third-quarter diluted EPS in the range of 60 to 66 cents.

**Slide 16: Upcoming Investor Events**

That concludes my formal review of our financial results. Before we transition to Q&A, I will note that slide number 16 highlights the various investor conferences we plan to participate in over the next couple of months.

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.