NETSCOUT SYSTEMS, INC.
Second-Quarter Fiscal Year 2020 Financial Results Conference Call
Management's Prepared Remarks

October 31, 2019

Tony Piazza: Introduction

Thank you, operator, and good morning everyone. Welcome to NETSCOUT'S second-quarter fiscal year 2020 conference call for the period ended September 30, 2019. Joining me today are:

- Anil Singhal, NETSCOUT's 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. You can advance the slides in the webcast viewer to follow our commentary. Both the slides and the prepared remarks can be accessed in multiple areas within the investor relations section of our website at www.netscout.com including the IR landing page under financial results, the webcast itself and under financial information on the quarterly results page.

Slide #3: Safe Harbor Statement

Moving on to slide number 3, today's conference call will include forward-looking statements. These statements may be prefaced by words such as "anticipate," "believe," and "expect" and will cover a range of topics that are not strictly historical facts such as our financial guidance, our market opportunities and market share, key business initiatives and future product plans, along with their potential impact on our financial performance. These forward-looking statements involve risks and uncertainties and actual results could differ materially from the forward-looking statements due to known and unknown risks, uncertainties, assumptions and other factors, which are described on this slide and in today's financial results press release as well as in the Company's Annual Report on Form 10-K for the year ended March 31, 2019 and subsequent Quarterly Reports on Form 10-Q 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. The rationale for providing non-GAAP measures along with the limitations of relying solely on those measures is detailed on this slide and in today's press release. These measures should not be considered in isolation from or as a substitute for financial information prepared in accordance with GAAP. Additionally, as a result of the sale of the HNT tools business, we will provide certain organic non-GAAP performance trends, which removes HNT tools revenue for comparability purposes.

Reconciliations of all non-GAAP metrics with the applicable GAAP measures are provided in the appendix of this slide presentation, in today's earnings press release, and they are also on our website.

I will now turn the call over to Anil for his prepared remarks. Anil …

Anil Singhal:

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

Slide #6: Q2'20 Financial & Operational Highlights

- From a financial perspective, we delivered solid second-quarter fiscal year 2020 performance with both revenue and earnings per share exceeding the high end of our expectations for the quarter.
- Revenue for the quarter was 216.5 million dollars with corresponding earnings per share of 28 cents.
- The quarter benefited from a large cable service provider order, which was delayed from last quarter, as well as strong government spending, as previously approved projects were funded this quarter.
- From a strategic perspective, we continue to advance our product initiatives at a steady pace and have made great progress on our go-to-market initiatives, including our sales force integration that started at the beginning of our fiscal year.

Let's move to slide 7 for some further perspective on this as we review business highlights.

Slide #7: Business Highlights

Service Provider Customer Segment

In our service provider segment, as noted earlier, this quarter we completed a deal with a large U.S. cable operator that had been in negotiations for several quarters. This customer is expanding into the Mobile Virtual Network Operator (MVNO) space where they are concentrating on optimizing their subscribers' experience. I am happy to report that the customer expanded their scope and is using a broad offering of our integrated platform to assist in achieving their objectives. This expanded scope resulted in a larger deal size than originally proposed. Michael will elaborate further on this transaction in his remarks.

As we mentioned on our last earnings call, during the second quarter, we received an 8-figure order from one of our tier 1 domestic mobile service providers for radio frequency propagation modeling as this customer prepares for 5G. Subsequent to the original order, the customer placed an incremental order which increased the size and scope of the project. We are working on the propagation modeling and expect that a significant portion of the project along with the associated revenue recognition should be completed in our fourth fiscal quarter, which enhances our visibility for that quarter as well as the second half of our fiscal year.

We are pleased to see carriers begin to prepare for 5G and we continue to engage with our customers on this front. While we continue to believe that this is a longer-term opportunity and driver of growth that will benefit our business in numerous ways, especially as edge computing becomes more mainstream, we are beginning to see some leading carriers accelerate their 5G initiatives. Within our international service provider geographies, we continue to see

4G-LTE related opportunities throughout EMEA, Latin America, and emerging Asia Pacific countries as they advance their networks.

Enterprise Customer Segment

Turning to our Enterprise segment, as we have said before, we have a large pipeline of user-approved orders within our federal government business that has been waiting for funding. During this quarter we benefited from the release of funds for some of our pipeline. Although some of these orders were completed during our second quarter, we had a few other orders that will be completed in our third fiscal quarter. Michael will elaborate on these deals in his remarks.

Overall, within the enterprise segment, our customers continue to advance their digital transformation and security initiatives. Given that our customers operate some of the most complex networks in the world, the evaluation and implementation of these newer technologies takes time and we anticipate these orders to be uneven throughout the quarters. However, we expect the pattern to level-out over time as these projects mature and believe we should benefit from this during the second half of the fiscal year and beyond.

Now let's move to slide number 8 to review our outlook.

Slide #8: Outlook & Summary

We remain excited about the opportunities we are seeing and our ability to capitalize on them. Given the solid performance in the quarter, the view of our pipeline, and the deals in-house related to the federal government and the radio frequency propagation modeling projects that should benefit the second half of the fiscal year, we are reaffirming our original revenue guidance range of 895 million dollars to 915 million dollars and increasing our earnings per share guidance range to one dollar and 45 cents ($1.45) to one dollar and 50 cents ($1.50), due to our capital structure management. The original range was one dollar and 40 cents ($1.40) to one dollar and 45 cents ($1.45).

I look forward to sharing our progress with you as the year continues.

I'll turn the call over to Michael at this point.

Slide #10: COO Update

Michael Szabados:

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

Customer Wins:

In the service provider segment, we won an 8-figure deal with a leading U.S. Cable Company as they advance their strategy to expand into the Mobile Virtual Network Operator (MVNO) space. Our customer's objective is to use a superior customer experience as their differentiator. In order to help ensure service quality and availability of their WiFi and Mobile Video services, they are deploying solutions from both our service assurance and DDOS security portfolios to assist in ensuring an optimal customer experience.

This deal is the initial phase of a company-wide instrumentation initiative and includes our core ISNG and nG1 platform, our nBA Customer Experience Analytics software, our nPulse Synthetic testing platform, and our flagship Sightline and TMS products from the Arbor security portfolio.

In the enterprise segment, we had multiple seven to low eight-figure deals from the Federal Government. The common theme in these deals is the indispensable role we play in assuring the performance and availability of large-scale, mission-critical systems.

In the largest of these transactions, we are part of the first phase of a new initiative to ensure end-to-end visibility, continuous monitoring, and remediation in conjunction with the orchestration of mandated security solutions in a hybrid cloud environment, initially involving

AWS Gov Cloud services. In this deal, we leveraged our entire service assurance arsenal of offerings, including active and passive monitoring and monitoring switches, predominantly in software and virtual form factors.

In another case we displaced the incumbent due to our strong reputation and track record with the Government based on our success with our superior service assurance technology and our extensive knowledge of their requirements and internal operations.

Finally, in the third deal, we leveraged our platform strength combined with our superior agility to customize a solution to meet a uniquely strict monitoring accuracy requirement in a mission-critical application, which helped to refresh our own incumbent solution after many years of dependable service.

Go-to-Market Activities

From a go-to-market perspective, we continue to successfully expand our partnerships.

With AWS, we recently completed the first deployment of our vStream and vnGeniusONE products by a large government agency in AWS GovCloud. Our capabilities now include both agent-based deployment inside the workload and separate VPC deployment in combination with AWS traffic-mirroring. This illustrates the importance of NETSCOUT's visibility in assuring the performance of applications migrating to AWS GovCloud. It also highlights the benefits of our advanced technology partnership between AWS and NETSCOUT in terms of delivering to market well architected and fully interoperable solutions. We will further demonstrate these capabilities of assuring performance and security of applications in hybrid cloud environments at the upcoming AWS re:Invent conference in Las Vegas.

With VMware, we announced the availability of our vSTREAM NSX Edition for VMware NSX-T, extending our leading visibility and troubleshooting analytics platform to be deployed natively and invisibly to the workload, in the virtual infrastructure for the data center and cloud for deep visibility and consistent security.

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

Slide #11: CFO Review

Jean Bua:

Thank you, Michael, and good morning everyone. I will review key second quarter and first-half fiscal year 2020 metrics, along with our guidance. As a reminder, this review focuses on our non-GAAP results unless otherwise stated, and all reconciliations with our GAAP results appear in the presentation appendix. In addition, due to the sale of the HNT tools business in mid-September of 2018, I will highlight certain revenue trends on an organic non-GAAP basis, which removes HNT tools revenue for the applicable period referenced. Regardless, I will note the nature of any such comparisons.

Slide #12: Q2 and First Half FY'20 Results

Slide number 12 details our results for the second quarter and first half of fiscal year 2020. Focusing on the quarterly performance, we reported revenue of 216.5 million dollars, which slightly exceeded the high end of our "color" for the quarter as Anil outlined in his remarks. Second-quarter revenue declined by around 3 percent on a year-over-year basis but was flat on an organic basis, after excluding approximately 8 million dollars associated with the HNT tools business.

Our second-quarter fiscal year 2020 gross margin was 76.6 percent, up over one-half of a percentage point over the same quarter last year. Quarterly operating expenses were down over 2 percent from the prior year primarily due to lower personnel-related costs resulting from reduced headcount. We reported an operating profit margin of 14.6 percent with diluted earnings per share of 28 cents.

Slide #13: 1H FY'20 Revenue Trends: Customer Verticals & Geographic Mix

Turning to slide 13, I'd like to review key revenue trends for the first half of the year. For the first six months of fiscal year 2020, the service provider customer segment revenue grew approximately 2 percent and the enterprise segment declined approximately 6 percent, after removing the revenue impact of the HNT Tools business that was divested last year.

Approximately 52% of total revenue was generated from the service provider segment with the remainder from the enterprise. Revenue by geography was relatively consistent with the first half of the prior year. There were no customers in the quarter or the first half of the year that represented 10% or more of revenue.

Slide #14: GAAP Balance Sheet Highlights & Free Cash Flow

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 307.8 million dollars, which is a decrease of 135.4 million dollars since the end of the first quarter. Free cash flow used in the quarter was 6.8 million dollars. During the quarter, we repurchased approximately 2.9 million shares of our common stock at a cost of 66.8 million dollars or an average price of 23 dollars and 34 cents ($23.34) per share. In the first half of this fiscal year, we've returned approximately 100 million dollars, or over two-thirds of our anticipated free cash flow for the fiscal year, back to our shareholders. We anticipate continuing to be active in the market, depending on market conditions and subject to daily trading volumes and price considerations.

In addition to our share repurchases, we also repaid 50 million dollars of debt during the second quarter and we now have 450 million dollars outstanding on our one-billion-dollar revolving credit facility.

To briefly recap other balance sheet highlights, accounts receivable, net, was 202.3 million dollars, up by 42.2 million since the end of June. DSOs were 79 days versus 88 days at the end of fiscal year 2019 and 73 days at the same time last year. The increase in the DSO's in the second quarter of this year compared with the second quarter of the prior year is primarily attributable to the timing of a payment from one large customer that has paid subsequent to the end of the quarter. Normalizing for this, the DSO was relatively flat this quarter compared with the same quarter last year.

Slide #15: FY'20 Guidance

Let's move to slide 15 for guidance. I will focus my review on our non-GAAP guidance. As a reminder, we sold the HNT tools business in September 2018 and it contributed 18.0 million dollars to last year's revenue prior to the completion of the sale. Accordingly, the impact of the divestiture should be taken into consideration when comparing fiscal years 2019 and 2020, especially for the first two quarters of both years.

FY'20 Non-GAAP Guidance

Consistent with Anil's remarks, we continue to target fiscal year 2020 revenue in the range of 895 to 915 million dollars, which implies low single-digit organic growth. In terms of the other key fiscal year 2020 operating model assumptions outlined on this slide, we currently anticipate gross margin to be relatively flat compared to last year as improvements from adoption of our software solutions are offset by the increased radio frequency propagation modeling activities where the initial phases have a higher associated cost. Our plan currently calls for lower operating costs compared with last year as we benefit from a reduction in personnel related costs primarily attributable to lower head count partially offset by increases in annual merit adjustments. We expect our non-GAAP tax rate to be in the range of 22 to 24 percent.

Assuming 76.7 million shares outstanding, we anticipate delivering mid to upper-single-digit earnings growth with diluted EPS increasing to a range of one dollar and 45 cents ($1.45) to one dollar and 50 cents ($1.50), due to our capital structure management. The original range was one dollar and 40 cents ($1.40) to one dollar and 45 cents ($1.45).

Q3 FY'20

I'd also like to offer some additional color on the third quarter. As a reminder, last year's third-quarter revenue of 246.3 million dollars was not impacted by the sale of the HNT tools business as the sale was completed in the second quarter of last year. As we assess the timing of opportunities in front of us, we currently anticipate revenue in the range of 245 million dollars to 255 million dollars. Diluted EPS for the third quarter is expected to range from 57 to 60 cents.

That concludes my formal review of our financial results. Before we transition to Q&A, I'd like to quickly note that our upcoming IR conference participation is listed on slide 16.

I'll now turn the call over to the operator to start Q&A.