NETSCOUT SYSTEMS, INC.
First-Quarter Fiscal Year 2022 Financial Results Conference Call
Management's Prepared Remarks

July 29, 2021

Anthony Piazza: Introduction

Thank you, operator, and good morning everyone. Welcome to NETSCOUT'S first-quarter fiscal year 2022 conference call for the period ended June 30, 2021. Joining me today are:

- Anil Singhal, NETSCOUT's president and chief executive officer;
- 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 outlook, 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 these 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, 2021, 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.

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 first-quarter non-GAAP results.

Slide #6: Q1'22 Financial Highlights

- We had a solid start to the fiscal year.
- First-quarter revenue increased more than 3 percent to 190.3 million dollars, compared with the same quarter last year.
- Strong product revenue growth in both the service assurance and cybersecurity product lines more than offset lower service revenue and drove our revenue increase while contributing to our strong diluted earnings per share performance.
- Diluted earnings per share increased more than 17 percent to 20 cents, compared with same quarter last year.

Let's move to slide 7 for some further perspective as we review business insights and market trends.

Slide #7: Business Insights and Market Trends

Service Provider Customer Vertical

In our service provider customer vertical, revenue grew approximately 10 percent compared with the same quarter last year. This growth was partially attributable to large domestic cable operators investing in their 5G core and edge environment solutions. We also benefited from an international carrier customer accepting completion of an implementation earlier than anticipated, so we recognized revenue a quarter earlier than planned.

During the quarter, we also received a low-eight-figure Radio Frequency Propagation Modeling order from a Tier-1 North American carrier as they progress their 5G network planning. We anticipate that we will be able to complete these projects by the end of our fiscal year.

Within the service provider market, we have started seeing some momentum around 5G network advancements globally. Michael will discuss some of these wins during his remarks.

Enterprise Customer Vertical

Turning to our enterprise customer vertical, revenue declined approximately 1 percent compared with the same quarter last year. Low-single-digit revenue growth in the service assurance area was offset by a mid-single-digit decline in the enterprise security area, primarily attributable to reduced spending from the financial institution sector compared to the same quarter in the prior year.

Despite the relatively flat overall enterprise customer vertical performance in the first quarter, we see opportunity in this vertical for the full fiscal year as customers accelerate cloud migrations and cybersecurity investments. The ability of our solutions to provide visibility and protection during a cloud transition and in hybrid or multi-cloud environments gives customers the control and confidence required to innovate. Some recently launched solutions, which include Smart Edge Monitoring and Omnis Cyber Investigator, help address these visibility and cybersecurity needs.

Our Smart Edge Monitoring solution uses an innovative approach, that combines smart data analytics and synthetic transaction testing, to assist in early identification and rapid resolution of performance issues to protect the digital experience from anywhere. This unique solution gives IT teams complete visibility and insight to assure the highest-quality end-use experience in any network or application, regardless of where employees perform their job.

We believe our new products will gain greater traction as our sales team resumes traveling, conduct in-person customer meetings and complete proof of concepts that demonstrate the value of our solutions in reducing mean-time-to-resolution of issues while saving time and expense. Michael will highlight some of the customer wins we experienced in this vertical during the quarter in his remarks.

In the longer term, we see potential opportunities emerging in the enterprise customer vertical for 5G utilization as enterprises and governments look to leverage 5G technology in private networks, through network slices, and at the edge. NETSCOUT is one of only a handful of vendors that have both service provider and enterprise knowledge in providing both scale and functionality. This should serve us and our customers well as 5G advancements unfold in the future.

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

Slide #8: Outlook & Summary

With one quarter behind us, we are off to a solid start to the fiscal year. As the world continues to emerge from the pandemic, we remain focused on meeting our customers' needs for service assurance and cybersecurity solutions that solve some of the connected world's toughest challenges.

As we advance our new service assurance and Omnis cybersecurity solutions and resume normal customer interactions selling these solutions, we believe sales will accelerate toward the second half of the fiscal year. We also believe we will build greater momentum with our "NETSCOUT without Borders" initiative that is focused on expanding our business with existing customers by leveraging our incumbency to access both existing and new budgets, acquiring new customers through new consumption choices, and expanding our reach into high-value adjacencies, such as expanded cybersecurity and big data analytics, that can leverage our "Smart Data."

We remain committed to delivering within the non-GAAP fiscal year 2022 outlook that was provided on our May 6, 2021 earnings call, which calls for low-single-digit revenue growth and enhanced diluted earnings per share at the mid-points of our outlook. Jean will recap the numbers during her remarks.

Finally, I am proud to announce that we recently issued our inaugural Environmental, Social, and Governance (ESG) Report, which is available in the Company section of our website at www.NETSCOUT.com. While ESG is a growing area of interest for a diverse set of stakeholders, these principles have always been a part of who we are at NETSCOUT. To obtain greater insight into how we think about ESG and our efforts in this area, I invite you to explore this new report and join us as we strive to increase our positive impact on the world.

I look forward to sharing our progress with you as the fiscal year progresses. I'll now turn the call over to Michael for his remarks.

Slide #9: 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 customer vertical, we continue to see some momentum around 5G globally. Some customers continue their planning, with Radio Frequency Propagation Modeling projects, while others are starting initial deployments.

During the quarter, we won a couple of low-seven-figure deals in the large domestic cable operator space where they are using both our service assurance and cybersecurity solutions as they build out their 5G core data centers or protect their edge environments. Internationally, we won a low-seven-figure deal with a mobile carrier in Asia, related to core to RAN service assurance visibility for their initial rollout of 5G. We successfully won these deals due to our superior technology, comprehensive solutions, and incumbency, despite the competitive bid processes used in some of these transactions.

In the enterprise customer vertical, we continue to gain traction with existing as well as new customers. Within the pharmaceutical sector, we closed two low-seven-figure deals with two leading pharmaceutical manufacturers. First, with a long-standing customer that leverages our solutions for visibility of all the network traffic related to their manufacturing operations.

Our proactive application visibility is trusted to ensure operations run smoothly by identifying and assisting in mitigating service disruption. This customer also deploys our cybersecurity solutions given the unwelcomed interest from bad actors due to the Company's trade secrets and medical importance. Second, a new customer purchased our service assurance solutions to replace an incumbent's product to gain superior visibility as they transition their hybrid infrastructure and advance their digital transformation. This deal was won during a highly competitive bid process. Both wins demonstrate the critical value of our comprehensive and powerful solution in winning deals by leveraging our incumbency and in securing new customers.

Go-to-Market Activities:

On the go-to-market front, we continue to focus on advancing our cybersecurity and public cloud brand awareness. Beyond marketing campaigns, we are also attending leading trade shows to showcase our brand and solutions.

Later this month, NETSCOUT will attend the virtual version of Black Hat 2021 and later this year we will be attending the AWS Re:Invent conference in Las Vegas. At the Black Hat event, we will showcase our Omnis Cybersecurity and Arbor DDoS solutions as well as host presentations addressing the threat of triple extortion being used by ransomware gangs. During these events, we will demonstrate how our visibility and cybersecurity solutions can be leveraged to detect, investigate, and respond to these threats and reduce mean-time-to-resolution and cost while fostering collaboration between IT and Security operations teams. At the AWS Re:Invent conference we will support our partnership with AWS and showcase our visibility tools that can be leveraged in cloud environments.

That concludes my prepared remarks, 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 metrics for our first quarter along with our outlook. As a reminder, this review focuses on our non-GAAP results unless otherwise stated, and all reconciliations to our GAAP results appear in the presentation appendix. Regardless, I will note the nature of any such comparisons.

Slide #12: Q1 FY'22 Results

Slide number 12 details our results for our first quarter of fiscal year 2022. Revenue grew 3.5 percent over the same quarter in the prior fiscal year to 190.3 million dollars. Product revenue grew 14.3 percent and service revenue declined 3.4 percent over the prior fiscal year's quarter. The decline in service revenue is due to non-renewals associated with service provider consolidation and discontinued product lines.

Our first-quarter fiscal year 2022 gross profit margin was 74.2 percent, down 0.4 percentage points over the same quarter last fiscal year as inventory associated with discontinued products was reserved. Quarterly operating expenses increased 2.4 percent from the prior fiscal year, largely due to variable sales compensation and increased cost associated with our first quarter sales kick off and Engage events. We reported an operating profit margin of 11.4 percent compared with 11.2 percent in the same quarter last fiscal year. Diluted earnings per share was 20 cents, up 17.6 percent from the same period last fiscal year.

Slide #13: Q 1 FY'22 Revenue Trends: Customer Verticals

Turning to slide 13, I'd like to review key revenue trends for the first quarter. In the service provider customer vertical, revenue grew 9.6 percent while the enterprise customer vertical declined 1.1 percent.

Approximately 54 percent of total revenue was generated from the enterprise customer vertical with the remainder from the service provider customer vertical.

Slide #14: Q 1 FY'22 Revenue Trends: Geographic Mix

Turning to slide 14, which shows our geographic revenue mix, on a GAAP basis. Revenue by geography continues to be domestically weighted but international revenue increased compared to the same quarter in the prior year. There was no customer that represented 10 percent or more of revenue in the quarter.

Slide #15: GAAP Balance Sheet Highlights & Free Cash Flow

Slide 15 details our balance sheet highlights and free cash flow. We ended the quarter with cash, cash equivalents, and short-term and long-term marketable securities of 493.9 million dollars, which is an increase of 17.5 million dollars since the end of the fourth quarter of fiscal year 2021. Free cash flow generated in the quarter was 21.5 million dollars. We currently have capacity on our share repurchase authorization and, depending on market conditions, plan to be active in the market. We did not repurchase any of our common stock during the first quarter of the fiscal year.

From a debt perspective, as of the end of the first quarter, we had 350 million dollars outstanding on our revolving credit facility. On July 27, 2021, we leveraged the favorable financing market environment to amend and extend our revolving credit facility. The amended 800-million-dollar revolving credit facility extends the maturity from January 2023 to July 2026, increases financial flexibility, and lowers financing cost.

To briefly recap other balance sheet highlights, accounts receivable, net, was 146.2 million dollars, down by 51.5 million dollars since the end of March. DSOs were 63 days versus 75 days at the end of fiscal year 2021 and 57 days at the same time last year. The increase in the DSOs in the first quarter of this year compared with the first quarter of the prior year is primarily attributable to the timing of when orders were received in the quarters.

Slide #16: FY'22 Financial Outlook Commentary

Let's move to slide 16 for commentary on our outlook. I will focus my review on our non-GAAP outlook.

FY'22 Non-GAAP Financial Outlook

As Anil noted in his earlier comments, we are reiterating the non-GAAP outlook that was presented on our May 6, 2021, earnings call. For fiscal year 2022, the expected revenue range is 835 to 865 million dollars, which implies low single-digit growth. The anticipated effective tax rate is expected to be between 21 and 23 percent as we incorporate the impact from the recent UK tax legislation change increasing their tax rate from 19 percent to 25 percent. Assuming approximately 75 million weighted average diluted shares outstanding, the non-GAAP diluted earnings per share range is expected to be between 1 dollar and 71 cents ($1.71) and 1 dollar and 77 cents ($1.77).

The GAAP diluted net income per share range has been updated to account for certain charges, including the impact of the amendment of our revolving credit facility.

I'd also like to offer some "color" on the non-GAAP outlook for the first half of the fiscal year. As we assess the opportunities in front of us, we currently anticipate approximately 1.5 percent revenue growth with corresponding mid-single-digit diluted earnings per share growth compared with the first half of the prior fiscal year.

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 17.

Thank you, and I'll now turn the call over to the operator to start Q&A.