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

January 27, 2022

Tony Piazza: Introduction

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's third-quarter fiscal year 2022 conference call for the period ended December 31, 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. Examples of forward-looking statements include statements regarding our future financial performance or position, results of operations, business strategy, plans and objectives of management for future operations, and other statements that are not historical fact. You can identify forward-looking statements by their use of forward-looking words such as "anticipate," "believe," "plan," "will," "should," "expect," or other comparable terms. We caution listeners not to place undue reliance on any forward-looking statements included in this presentation which speak only as of today's date. 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, 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 the 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…

Slide #5: CEO Perspective
Anil Singhal:

Thank you, Tony. Good morning, everyone, and thank you all for joining us today. Let's begin on slide number 6 with a brief recap of our third quarter and first nine months non-GAAP results.

Slide #6: Q3 and First Nine Months FY'22 Financial Results

- During the third quarter, we delivered strong performance across the board.
- Higher quarterly sales, margins, and profitability were mainly driven by increased enterprise customer demand and customers' acceleration of orders, primarily within the service provider vertical, of approximately 25 to 30 million dollars that were previously forecasted to occur in our fourth quarter.
- As a result, we achieved strong top-line growth, with revenue increasing more than 14 percent year over year to 262.2 million dollars. Product revenue grew more than 25 percent, and service revenue grew more than 3 percent, both on a year-over-year basis.
- We exited the third quarter with a product backlog of approximately 30 million dollars in unshipped orders, which excludes radio frequency propagation modeling orders.
- Moving to our bottom-line, based on the third quarter's revenue performance and product mix, diluted earnings per share increased to 89 cents from 66 cents a year ago, an increase of approximately 35 percent.
- On a year-to-date basis, revenue in the first nine months of fiscal year 2022 increased more than 7 percent to 664.4 million dollars. This was driven by product revenue growth of more than 17 percent, partially offset by a 0.8 percent decline in service revenue. Diluted earnings per share increased approximately 29 percent to 1 dollar and

56 cents for the first nine months of the fiscal year. These comparisons are all made on a year-over-year basis.

- In summary, our strong third-quarter performance has further demonstrated the financial strength of our business model. This success, combined with our year-to-date results, has provided us with even greater clarity into our full fiscal year outlook and the confidence to update it. I will provide more details on all of this later in my remarks.

Let's now move to slide 7 for some further perspective on market and business insights.

Slide #7: Market and Business Insights

Starting with markets, we continue to see digital connectivity increasing around the world, accelerated by the pandemic and longer-term technology trends. NETSCOUT now has more than three decades of experience providing service assurance and cybersecurity solutions at the crossroads of modern business performance and cutting-edge technology. Since our inception, we have developed a solid reputation for being innovative, delivering industry-leading solutions, and cultivating close-knit customer relationships. Our established mindshare and best-in-class solutions have positioned us well to capitalize on the world's growing connectivity.

To address the latest challenges of customers dealing with the "new normal," hybrid workforces, edge activity, and the ever-expanding cybersecurity threat landscape, we recently released several new products, including Smart Edge Monitoring and our Omnis Cyber Intelligence. We are excited about the potential of our recently released products and services, which are starting to gain traction, and believe these offerings will help further accelerate our business momentum in the next fiscal year and beyond. We are also actively working with many of our partners to better integrate our solutions into their ecosystems and thereby enhance the overall quality and technical capabilities of their technology tools. Michael will provide more context on these developments during his remarks.

Now, I'd like to discuss our customer verticals to provide more perspective on our performance as well as the related trends that we are seeing.

Service Provider Customer Vertical

For the first three quarters of the fiscal year, we grew revenue in our service provider customer vertical by more than 7 percent year over year. As mentioned earlier, in the third quarter, several service provider customers accelerated orders with us that were previously anticipated to occur in the fourth quarter of our fiscal year 2022.

In terms of trends for this vertical, we continue to see 5G being deployed globally and our radio frequency propagation modeling solutions being used in carrier planning. Last week, for example, two Tier-1 domestic carriers "lit-up" their 5G networks as they leveraged mid-band spectrum to deliver their solutions. Meanwhile, the latest FCC mid-band spectrum auction in the US just raised over 22 billion dollars. These events further underscore the industry's steady progress and persistent interest in 5G-related initiatives.

We continued to win notable service provider deals in the third quarter, which included more 5G-related orders from Tier-1 domestic and international carriers. We also won a second large radio frequency propagation modeling order from a Tier-1 domestic carrier as the organization continues to advance its 5G network planning. Michael will comment on some of these service provider wins in his remarks.

Enterprise Customer Vertical

Now, moving to our enterprise customer vertical. Revenue for this vertical grew by more than 7 percent year over year in the first three quarters of our fiscal year.

In line with our remarks from last quarter, we continue to see enterprise customers moving from reactivity to proactivity in their execution, as they restart projects previously delayed by the pandemic and adjust to the "new normal" of today's operating environment. Michael will highlight some of the customer wins we achieved during the quarter in this vertical in his remarks.

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

Slide #8: Outlook & Summary

Looking back on our business performance so far, we have delivered three quarters of solid results with strong business momentum. Importantly, our third quarter performance has demonstrated the financial strength of our business model and provided us with even greater clarity and confidence regarding our fiscal year 2022 forecast. We remain on track to meet our financial objectives for the full fiscal year. And, after considering all these factors, we have made the decision to update our full-year guidance, raising our revenue mid-point and increasing our EPS outlook for fiscal year 2022. These updates reflect our expectation for lower product revenue in the fourth quarter, attributable to the previously mentioned acceleration of orders by customers and movement of revenue from the fourth quarter to our third quarter results. It also reflects our expectation to end the fourth quarter with a product backlog of unshipped orders similar to that of the third quarter. Jean will provide additional color and a recap on the numbers in her remarks.

In conclusion, we have performed well year-to-date, our visibility has further improved, and our business model has demonstrated significant financial strength. We remain excited about our future growth prospects, and I look forward to sharing our final fiscal year 2022 results and our fiscal year 2023 outlook with everyone on our next earnings call.

With that, I'll turn the call over to Michael.

Slide #9: COO Update

Michael Szabados:

Thank you, Anil, and good morning, everyone. Slide 10 outlines the areas that I will be covering today.

Customer Wins:

We continue to see momentum around 5G in our service provider customer vertical. As Anil mentioned, we received 5G-related orders from both domestic Tier-1 as well as international carriers in the third quarter. One of these deals was a low-eight-figure order for our 5G-related solutions from a certain domestic Tier-1 carrier, which represents the third 5G-related order this carrier has placed with us. The international market also continued to show momentum. We received a mid-seven-figure order for our 5G-related solutions from an international carrier in the third quarter, which represents the second 5G-related order from this organization. We also received a second low-eight-figure order from a domestic Tier-1 carrier for additional radio frequency propagation modeling services as the carrier continued to plan its 5G network build out. As these carriers increasingly look to integrate 5G capabilities and further advance the competitiveness of their offerings, our unique combination of market-leading solutions, depth of experience, responsive customer service, and strong relationships continue to win us business in the service provider market.

We have also continued to observe renewed momentum within our enterprise customer vertical. As Anil touched on earlier, these customers are now in the process of refocusing on those important projects that were either previously delayed due to pandemic constraints or newly created as a result of the broad impact of the pandemic on underlying digital transformation trends today. We are well-positioned to capitalize on this momentum, and our robust suite of offerings is gaining traction with both existing and new enterprise customers.

During the third quarter, for example, we won a low seven-figure deal with a new customer that is a global household and consumer products company headquartered in the U.S. By demonstrating to the customer our ability to help protect its critical business services from disruptions, we were able to win this deal after only a short sales cycle. Once the customer's IT operations experienced a massive data center breakdown, their IT operations management team realized they did not have the ability to resolve, let alone prevent, such problems using their existing tools. This is another example of the rapidly growing complexity within IT. Today, IT has already reached a critical threshold that necessitates visibility at a larger scale than possible with conventional IT tools. Beyond this example, and due to the result of similar IT challenges, we have won several noteworthy new clients, including a new agency in the US Department of Defense. These wins further demonstrate the highly differentiated nature of our approach as well as the depth and breadth of our offerings, which continue to serve us well in today's dynamic and constantly evolving digital economy.

Go-to-Market Activities:

Now, turning to our go-to-market activities. On this front, we remain focused on cultivating strong partnerships, integrating solutions, and preparing for our Engage 2022 Annual User and Technology Summit.

From a partnership and integration perspective, we recently announced several new and continuing collaborations. To highlight a few, in early-November 2021, we reported that Amazon Web Services (AWS) customers will now be able to use our Omnis Cyber Intelligence (OCI) integration with AWS Security Hub for added visibility and security when migrating workloads to AWS. Earlier this month, we also announced our collaboration with AWS in support of ENGIE IT, the IT subsidiary of a worldwide low-carbon energy supplier, ENGIE, to seamlessly migrate its workloads and services to the cloud in support of the company's digital transformation journey. Finally, at the end of last year, we announced a new integration that connects NETSCOUT's nGeniusONE® service assurance solution with ServiceNow® IT Operations Management (ITOM) Visibility and ITOM Health. Our integration module is enabling nGeniusONE to generate enhanced alerts to ServiceNow® ITOM with a contextual launch capability for service triage. We are excited about these partnerships, the people we are working with, and the quality of our solution integrations thus far. Through these collaborations, we can help our customers navigate our increasingly connected and interdependent world with more confidence and protection so they can focus on what matters most to their organizations.

Looking ahead, NETSCOUT plans to host its customers and partners at its Annual Engage Technology and User Summit from April 25th to April 28th this year in Orlando, Florida. As an annual tradition, this event is a true highlight of the year for NETSCOUT. At Engage 2022, we plan to showcase our cybersecurity, service assurance, and DDoS capabilities through presentations, panel discussions, demonstrations, and hands-on training. This event will also provide us with more opportunities to meet with our user and partner communities to discuss and solicit feedback regarding our Visibility Without Borders offerings.

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 now review our key third quarter and year-to-date fiscal year 2022 metrics. 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. Regardless, I will note the nature of any such comparisons.

Slide #12: Q3 and First Nine Months FY'22 Results

Slide number 12 details the results for our third quarter and year-to-date fiscal year 2022. Focusing on the quarterly performance, revenue grew 14.6 percent over the same quarter in the prior year to 262.2 million dollars. Product revenue grew 25.6 percent and service revenue grew 3.5 percent over the prior year's quarter.

Our third-quarter fiscal year 2022 gross profit margin was 78.8 percent, up 0.2 percentage points over the same quarter last year, primarily attributable to product volume and mix. Our third quarter "software-only" revenue was 34 percent of our service assurance product revenue, compared to 31 percent in the same period last fiscal year. Quarterly operating expenses increased 3.5 percent from the prior year, largely due to investments in sales and marketing. We reported an operating profit margin of 33.2 percent compared with 28.2 percent in the same quarter last year. Diluted earnings per share was 89 cents compared with 66 cents in the same quarter last year.

Slide #13: First Nine Months YTD FY'22 Revenue Trends: Customer Verticals

Turning to slide 13, I'd now like to review key revenue trends for the first nine months of fiscal year 2022. Year to date, the service provider customer vertical revenue grew approximately 7.4 percent, while the enterprise customer vertical grew approximately 7.7 percent.

Approximately 51 percent of total revenue for the first nine months of the fiscal year was generated from the service provider customer vertical, while the remaining 49 percent was from the enterprise customer vertical.

Slide #14: First Nine Months 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. Both domestic and international revenue increased on a year-to-date basis. For both the third quarter and first nine months of the fiscal year, there was one customer that represented 10% or more of total revenue.

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 553.5 million dollars in cash, cash equivalents, and short-term and long-term marketable securities, representing an increase of 77.7 million dollars since the end of the second quarter. Free cash flow generated in the quarter was 90.3 million dollars. We repurchased approximately 11.0 million dollars, or 409,379 shares, of our common stock in the quarter. From a debt perspective, as of the end of the third quarter, we had 350 million dollars outstanding on our 800-million-dollar revolving credit facility, which expires in July 2026.

To briefly recap other balance sheet highlights, accounts receivable, net, was 233.9 million dollars, up by 36.2 million dollars since the end of March. The DSO metric was 76 days versus 75 days at the end of fiscal year 2021 and 70 days at the same time last year.

Slide #16: FY'22 Outlook

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

FY'22 Outlook

As Anil noted earlier in his remarks, we have updated our full-year outlook, raising our revenue mid-point and increasing our EPS outlook for fiscal year 2022. We now expect fiscal year 2022 revenue to be in the range of 850 to 855 million dollars. Assuming approximately 75 million weighted average diluted shares outstanding, we expect non-GAAP diluted earnings per share to be between 1 dollar and 75 cents ($1.75) and 1 dollar and 78 cents ($1.78).

This update reflects our expectation for lower product revenue in the fourth quarter as a result of the previously mentioned acceleration of product revenue of approximately 25 to 30 million dollars from the fourth quarter into our third quarter results. It also reflects our expectation to end the fourth quarter with a product backlog of unshipped orders of approximately 30 million dollars, which excludes radio frequency propagation modeling projects and is similar to that of the third quarter.

That concludes my formal review of our financial results.

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