NETSCOUT SYSTEMS, INC.
First-Quarter Fiscal Year 2023 Financial Results Conference Call
Management's Prepared Remarks

August 4, 2022

Slide #2: Introduction
Tony Piazza:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's first-quarter fiscal year 2023 conference call for the period ended June 30, 2022. 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, including but not limited to those described on this slide and in today's financial results press release. For a 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, 2022, 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 now 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 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, and good morning, everyone. Welcome and thank you all for joining us today.

Let's turn to slide number 6 for a brief recap of our non-GAAP financial results for the first quarter of our fiscal year 2023.

Slide #6: Q1 FY'23 Non-GAAP Financial Results

- In the first quarter, we achieved a strong top- and bottom-line performance, extending our business momentum from our last fiscal year into our fiscal year 2023.
- Revenue was 208.8 million dollars, representing year-over-year growth of nearly 10 percent.
- Our strong revenue expansion was driven by approximately 20 percent product revenue growth and approximately 2 percent service revenue growth, both on a year-over-year basis.
- During the first quarter, our service assurance revenue grew by approximately 11 percent, while our security revenue grew by approximately 7 percent, both on a year-over-year basis.
- As a result, we grew our diluted EPS by approximately 20 percent year over year to deliver twenty-four cents ($0.24) per diluted share in the period.

Now, let's move to slide 7 for some further perspective on market and business insights.

Slide #7: Market and Business Insights

Security

On the security front, our new Omnis solution suite continued to gain recognition and traction in the marketplace as we further expanded its offerings. For example, we recently launched the Omnis Atlas Intelligence Feed (AIF) for smarter automated DDoS attack blocking. As a new, innovative AI-based solution, our Omnis AIF is continuously updated and enables the instantaneous blocking of a large portion of DDoS attacks, thus simplifying operations and minimizing risks for our customers' businesses. In recognition of our ongoing cybersecurity focus, we recently received the "Cyber Defense Magazine Global InfoSec" award for "Market Leader Network Detection and Response" as well as the "Fortress Cybersecurity" award in the "Threat Detection" category. Although the total contribution from our new Omnis solutions within our security portfolio remains small relative to our overall revenue, this solution suite continues to show solid potential, and we are seeing our customers' network and security teams beginning to understand the value of a shared visibility platform.

Now, let's turn to our customer verticals for more business insights, starting with our service providers.

Service Provider Customer Vertical

Service provider revenue in the first quarter grew approximately 27 percent year over year, primarily driven by radio frequency propagation modeling related revenue. We continue to see carriers invest in their 5G deployments, as evidenced by the number of radio frequency propagation modeling projects we are working on. During the first quarter, we also received additional 5G-related orders from both Tier-1 domestic and international carriers.

Enterprise Customer Vertical

Moving to our enterprise customer vertical, revenue declined by approximately 5 percent year over year in the first quarter of our fiscal year 2023. This decline was primarily due to the timing of enterprise customer order shipments. We remain confident in the health of this customer vertical, despite these fluctuations in the near term. Enterprises continue to demand best-in-class cybersecurity solutions as well as those solutions that can help facilitate the acceleration of their digital transformations.

Michael will provide more insight regarding customer orders in our verticals during his remarks.

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

Slide #8: Outlook & Summary

Looking ahead, we remain excited about the market opportunities we are seeing for both our existing and new solutions. From both a financial and business perspective, we remain confident in our underlying fundamentals and positioning, despite the persistence of various macro headwinds. As such, we are reiterating our non-GAAP outlook for our full fiscal year 2023. Jean will provide additional color and a recap of the numbers in her remarks.

In summary, our first quarter performance has extended our momentum into the new fiscal year while also providing us with a solid foundation going forward. Additionally, we remain encouraged by our ability to help customers address the challenges and opportunities of today's digital world effectively through our unique solutions. We look forward to sharing our progress with everyone throughout the remainder of our fiscal year.

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, starting with customer wins.

Slide #10: COO Highlights

Customer Wins

In our service provider customer vertical, we continued to see 5G-related activity both in domestic and international markets. For example, during the first quarter, we received mid-seven figure orders with 5G-related elements from a Tier-1 domestic carrier and an international carrier as they continued to advance their 5G network deployments. Notably, these were follow-on orders, as both carriers had placed 5G-related orders with us in the past.

Now, turning to our enterprise customer vertical. In the first quarter, we secured a low seven-figure deal with a law enforcement agency of a large U.S. city for a combination of our service assurance and security solutions. In order to win this deal, we collaborated with the customer's network and security operations teams, who consequently judged and evaluated our solutions. With requirements for more comprehensive insights and a scalable deep packet inspection solution to meet visibility and security needs, the customer's teams determined that our solutions were ideal, particularly when compared to a competitor's solution that was unable to fulfill the customer's requirements.

Our deployment for this customer utilizes the ISNG data sources for service assurance analytics, provided by our nGeniusONE stack, as well as the network-based detection and response capabilities of our new Omnis Cyber Intelligence stack. We are excited by this deal, particularly because it demonstrates how both network and security teams can leverage our scalable deep packet inspection technology to create a shared visibility platform, and we continue to see increasing customer interest in these types of use cases.

Go-to-Market Activities

Now, turning to our go-to-market activities. Importantly, we have continued to prioritize attending in-person events. We find these gatherings both effective and efficient, allowing us to demonstrate our solutions and engage with existing and prospective customers.

For our second fiscal quarter, we plan to attend the Black Hat conference, which takes place in Las Vegas and caters to the cybersecurity community. We also plan to attend VMware Explore, formerly known as VMworld, which takes place in San Francisco and is focused on enterprise digital transformation as well as cybersecurity. At these events, we will demonstrate how NETSCOUT and our customers are extending our visibility platform and underlying deep packet inspection technology into adjacent areas, ranging from cybersecurity to adaptive DDOS. We will also showcase how our solutions are incorporating our Omnis AIF intelligence feed, solving remote work service assurance challenges, and enhancing AI/Ops, analytics, and more.

As Anil mentioned, while our new cybersecurity solutions are already starting to receive recognition, our existing solutions in both security and service assurance are also generating further awareness. For example, in June, Forrester published its Total Economic Impact study on

Omnis AED. Commissioned by NETSCOUT, this report showed an impressive ROI of 201% over three years, effectively paying back the solution's cost in just 7 months. We also were recently awarded the "Digital Innovator" award in "Enterprise Digital Transformation" from Intellyx, an analyst and advisory firm, for our enterprise service assurance solutions.

With that, I'll conclude my prepared remarks for today. Thank you, everyone. 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 of fiscal year 2023 and provide some additional commentary on our fiscal year 2023 outlook. 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: Q1'23 Results

Slide number 12 details our first-quarter fiscal year 2023 results. During the quarter, total revenue grew 9.7% percent year over year to 208.8 million dollars. Product revenue grew 19.9% percent and service revenue grew 2.1% percent, both on a year-over-year basis.

Our first-quarter fiscal year 2023 gross profit margin was 74.5 percent, up 0.3 percentage points over the same quarter last year. Quarterly gross margin was impacted by the addition of approximately 15 million dollars in radio frequency propagation modeling projects, which had an average gross margin of less than 30 percent. Quarterly operating expenses increased 9.7 percent year over year, primarily attributable to the return to a "pre-pandemic" environment, including more in-person sales and marketing events as well as increased travel costs. We reported an operating profit margin of 11.7 percent, compared with 11.4 percent in the same quarter last year. Diluted earnings per share was 24 cents, compared with 20 cents in the same quarter last year, an increase of 20 percent year over year.

Slide #13: FY'23 Revenue Trends: Customer Verticals & Product Lines

Turning to slide 13, I'd now like to review key revenue trends by customer verticals and product lines.

For the first quarter of fiscal year 2023, on a year-over-year basis, our service provider customer vertical revenue grew 26.9 percent, while our enterprise customer vertical revenue declined 4.8 percent. During the quarter, our service provider customer vertical accounted for 53 percent of our total revenue, while our enterprise customer vertical accounted for the remaining 47 percent.

Now, turning to our product lines. In the first quarter of fiscal year 2023, our service assurance revenue increased by 11.0 percent year over year, while our security revenue increased by 6.7 percent year over year. During the first quarter, the service assurance product line represented approximately 72 percent of total revenue, while our security product line represented the remaining 28 percent.

Slide #14: FY'23 Revenue Trends: Geographic Mix

Turning to slide 14, which shows our geographic revenue mix. In the first quarter, our revenue was more concentrated than usual in the U.S. due to increased Tier-1 domestic carrier radio frequency propagation modeling project revenue. Also, two customers represented 10%

or more of our total 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 374.6 million dollars in cash, cash equivalents, and short and long-term marketable securities, representing a decrease of 328.6 million dollars since the end of fiscal year 2022. The decrease was primarily attributable to the two capital structure transactions we initiated in the first quarter of fiscal year 2023. The first transaction was the repayment of 150 million dollars of debt on our revolving credit facility, while the second transaction was the execution of an accelerated share repurchase agreement to repurchase up to 150 million dollars of our common stock. Through the accelerated share repurchase transaction, we received 70 percent of the estimated program shares upfront, or approximately 3.3 million shares. We anticipate receiving the remaining 30 percent when the program concludes, no later than the end of the third quarter of our fiscal year 2023. Free cash flow for the quarter was negative 14.9 million dollars. From a debt perspective, we ended the first quarter of fiscal year 2023 with 200 million dollars outstanding on our 800-million-dollar revolving credit facility, which expires in July 2026.

To briefly recap our other balance sheet highlights, accounts receivable, net, was 112.9 million dollars, a decrease of 35.3 million dollars since March 31, 2022. The DSO metric at the end of the first quarter of fiscal year 2023 was 44 days, versus 63 days at the end of the first quarter of fiscal year 2022 and 64 days at the end of our fiscal year 2022.

Slide #16: FY'23 Outlook

Let's move to slide 16 for commentary on our outlook. I will focus my review on our non-GAAP targets for fiscal year 2023.

FY'23 Outlook

As Anil noted earlier, we are reiterating our non-GAAP outlook for fiscal year 2023 that was presented during our May 5, 2022, fourth quarter and full fiscal year 2022 earnings call. As a reminder, for fiscal year 2023, we anticipate revenue in the range of 895 to 925 million dollars, which implies a mid-to-high single-digit topline growth rate. The effective tax rate is anticipated to be in the range of 20 to 22 percent, with the current rate at the upper end of that range. Assuming between 73 and 74 million weighted average diluted shares outstanding, which includes the estimated impact of the 150 million dollar accelerated share repurchase program, with a partial offset for stock compensation dilution, we expect non-GAAP diluted earnings per share to be between 1 dollar and 97 cents ($1.97) and 2 dollar and 3 cents ($2.03).

Q2 FY'23 Outlook

I'd also like to offer some "color" on the second quarter. As we assess the opportunities in front of us, we currently anticipate mid-single-digit revenue and EPS growth rates on a year-over-year basis.

That concludes my formal review of our financial results. Thank you, and I'll now turn the call over to the operator for Q&A.