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

October 27, 2022

Slide #2: Introduction
Tony Piazza:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's second-quarter fiscal year 2023 conference call for the period ended September 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 now turn to slide number 6 for a brief recap of our non-GAAP financial results in the second quarter and the first half of our fiscal year 2023.

Slide #6: Q2 & First Half FY'23 Non-GAAP Financial Results

- Focusing first on the second quarter of fiscal year 2023, we delivered strong financial results and drove progress across our strategic growth priorities during the quarter. Importantly, this included further expanding our cybersecurity business.
- Second quarter revenue was 228.1 million dollars, representing year-over-year growth of nearly 8 percent.
- Our revenue expansion was driven by 10 percent product revenue growth and more than 5 percent service revenue growth, both on a year-over-year basis.
- Of note, our cybersecurity and service assurance product lines continued to grow in the quarter on a year-over-year basis.
- With this revenue growth and our healthy operating leverage, we delivered 57 cents per diluted share in the second quarter of fiscal year 2023, representing diluted earnings per share growth of approximately 21 percent year over year.
- Now, moving to the first half of our fiscal year 2023. During the period, revenue was $436.9 million dollars, growing by nearly 9 percent year over year. This increase was driven by product revenue growth of more than 14 percent and service revenue growth of nearly 4 percent. During the same period, cybersecurity revenue grew by 14 percent,

while service assurance revenue grew by more than 6 percent. All comparisons are on a year-over-year basis.

- Additionally, we delivered 81 cents of diluted earnings per share in the first half of fiscal year 2023, representing diluted earnings per share growth of approximately 21 percent year over year.

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

Slide #7: Market and Business Insights

Starting on the cybersecurity front, we recently released our DDoS Threat Intelligence Report for the first half of 2022. In it, we highlighted many of the current trends and challenges within this critically important area. Our report findings demonstrate how adept and sophisticated cybercriminals have become at leveraging new DDoS attack vectors and their other methodologies to attempt to bypass organizations' defense measures. The report also highlighted the significant geopolitical implications of today's DDoS attackers. In short, many of these bad actors are openly embracing online aggression to cause disruption and geopolitical unrest through high-profile DDoS attack campaigns. Equipped with our state-of-the-art platform for increased visibility and defensibility, we play a vital role in this ecosystem and remain confident in our ability to help customers navigate these challenges while also capitalizing on the opportunities of today's digital world.

In line with these trends, our Omnis suite of cyber intelligence products has continued to gain traction, although it still only accounts for a small portion of our revenue stream. During the second quarter, for example, one of our large customers continued to integrate with the

NETSCOUT platform by incorporating Omnis into their current installation base. Additionally, we continued to innovate in the cybersecurity area, introducing new solutions like Arbor Insight, to help address the evolving threat landscape. When combined with Arbor Sightline, this solution can dramatically enhance and extend a company's capabilities in threat detection, service delivery, and network operator visibility.

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

Service Provider Customer Vertical

Service provider revenue increased by approximately 11 percent year-over-year in the first half of fiscal year 2023. This increase was primarily driven by higher revenue related to radio frequency propagation modeling projects from Tier-1 carriers in North America. Importantly, we continue to see carriers invest in their 5G deployments, both for planning purposes as well as for stand-alone build outs, where these same carriers also are starting to deploy commercial traffic.

Enterprise Customer Vertical

In our enterprise customer vertical, revenue grew by approximately 6 percent year over year in the first half of fiscal year 2023. This top-line expansion was driven by growth in both our cybersecurity and service assurance business lines, as enterprises continued to demand best-in-class cybersecurity solutions as well as visibility solutions capable of helping them to better protect their systems and facilitate the acceleration of their digital transformations. In addition, we are leveraging our growing set of comprehensive solutions to execute a platform approach, which is also starting to resonate with customers.

Michael will provide more insight regarding customer wins within our verticals during his remarks.

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

Slide #8: Outlook & Summary

Looking ahead, we plan to continue managing our operations prudently, taking a balanced approach to revenue growth and profitability. Overall, while we recognize the current uncertainty in the macroeconomic environment, we also remain confident about our business prospects and excited about the market opportunities we are seeing for our NETSCOUT visibility and defensibility platform. With this context, we are reiterating our fiscal year 2023 outlook that we shared with you in early August on our first quarter earnings call. As a reminder, this outlook targets revenue in the range of 895 million dollars to 925 million dollars and non-GAAP EPS in the range of 1 dollar and 97 cents to 2 dollars and 3 cents for fiscal year 2023. Jean will provide additional color on our outlook in her remarks.

In summary, we delivered solid results in the second quarter and first half of our fiscal year 2023. We are driving clear progress toward our strategic priorities, and we remain excited about our core service assurance and DDoS security solutions, as well as our new and innovative Omnis solutions. With our unique and powerful platform, deep industry expertise, and established customer base, we are well-positioned to help customers address the challenges and opportunities of today's increasingly connected and complex digital world. 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.

Customer Wins:

In our service provider customer vertical, we continued to expand our installed base by leveraging both our incumbency and rich portfolio of offerings to better support providers as they steadily advanced their 5G buildouts. As an example, during the quarter, we received a mid-seven figure order from a Tier-1 North American carrier that has consistently increased their 5G-related purchasing from us. This order was for a combination of additional radio frequency propagation modeling, service assurance for their Radio Access Network, and other 5G-related products to aid in the migration and capacity expansion of their network. Importantly, in addition to leveraging our solutions within their mobile business, this customer is also utilizing our service assurance platform within their corporate IT systems.

In our enterprise customer vertical, we received a low eight-figure order from a large North American health insurance organization during the second quarter. Last year, this customer placed a seven-figure order with us for our service assurance solutions, and, this quarter, they added our full Omnis cybersecurity suite and additional service assurance solutions to further utilize our platform's integrated capabilities. With the convenience of our shared visibility platform and power of our deep packet inspection at scale, we continue to see our comprehensive suite of enterprise solutions garnering attention among customers.

Finally, as Anil mentioned in his discussion of our recent Threat Intelligence Report, we continue to see an increased awareness around DDoS capacity expansion, stemming from the rapid growth in application traffic and increasingly tense geopolitical situation around the world. For example, in the second quarter, we received a mid-seven figure order from a large global financial institution that is based in the U.S. and is also a long-standing customer, to extend their DDoS mitigation capacity and upgrade their key data centers to 100 GB capacity.

Go-to-Market Activities:

Now, turning to our go-to-market activities. During the quarter, we continued to attend more in-person events, which provided us with additional opportunities to engage with our customers and demonstrate our platform's unique and innovative capabilities. For example, we recently attended the Black Hat conference, one of the world's leading cybersecurity trade shows, as well as VMware Explore, a conference for digital transformation and cybersecurity. At these high-profile events, we engaged with new prospects and existing customers to demonstrate the power of our platform for integrated visibility and cybersecurity. Looking ahead, we plan to attend the upcoming AWS re:Invent conference in November 2022, where we will showcase NETSCOUT's platform as well as our collaborations with AWS.

We also have continued to enhance our customer value propositions by collaborating with other major technology companies and have recently announced several of these initiatives. Through these collaborations, we can help our customers to better address the current threat landscape and navigate the challenges and opportunities of our digital world.

An example is a join strategic initiative with Ericsson and Swisscom, which was officially announced by Ericsson in October. Through this collaboration, we delivered what is believed to be the world's first solution for cloud-based packet data processing. By leveraging the strengths of each organization, this solution can deliver meaningful improvements in network service assurance, analytics, and cybersecurity. For example, this solution combines Ericsson's and NETSCOUT's technologies to address the challenges of providing end-to-end monitoring and securing 5G networks when handling cloudification and encryption. As a result, Swisscom is utilizing this solution in its newly deployed cloud-native, TLS-encrypted 5G network, as well as for its existing services, to assure the delivery of mission-critical services with 5G.

Going forward, we aim to continue leveraging the strength of our platform to help our customers better navigate and capitalize on emerging opportunities in today's increasingly connected world.

Thank you, everyone. 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 metrics for our second quarter and first half 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: Q2 & 1H FY'23 Results

Slide number 12 details the results for the second quarter and first half of our fiscal year 2023. Focusing on our quarterly performance, total revenue grew 7.6 percent year over year to 228.1 million dollars. Product revenue grew 10.0 percent and service revenue grew 5.4 percent, both on a year-over-year basis. At the end of the second quarter, our total "backlog" was approximately 80 million dollars, consisting of approximately 45 million dollars of fulfillable orders and approximately 35 million dollars of radio frequency propagation modeling projects, with nearly 20 million dollars of the radio frequency propagation modeling amount categorized as deferred revenue from an accounting perspective. As a reminder, while fulfillable orders are those we believe can be readily converted into revenue upon shipment or fulfillment, the radio frequency propagation modeling projects require certain execution steps, in conjunction with the carrier's timing, before they can convert to revenue.

Gross profit margin was 76.8 percent in the second quarter, down 1 point 5 percentage points year over year. This quarter's gross margin was impacted by approximately 15 million dollars of radio frequency propagation modeling projects, which had an average gross margin of less than 30 percent. Quarterly operating expenses increased 2.2 percent year over year, mostly due to the return of "pre-pandemic" activities, such as in-person events and travel, and partially due to a competitive employment market. We reported an operating profit margin of 23.7 percent, compared with 22.3 percent in the same quarter last year. Diluted earnings per share was 57 cents, compared with 47 cents in the same quarter last year, representing an increase of 21.3 percent year over year.

Slide #13: 1 H 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. Please note that all comparisons here are on a year-over-year basis, consistent with our other remarks.

For the first six months of fiscal year 2023, our service provider customer vertical revenue grew 11.0 percent, while our enterprise customer vertical revenue grew 6.4 percent. During the same period, our enterprise customer vertical accounted for approximately 51 percent of our total revenue, while our service provider customer vertical accounted for the remaining 49 percent.

Now, turning to our product lines. For the first half of fiscal year 2023, our cybersecurity revenue increased by 14.3 percent, while our service assurance revenue increased by 6.6 percent. During the same period, our service assurance product line accounted for approximately 73 percent of our total revenue, while our cybersecurity product line accounting for the remaining 27 percent.

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

Turning to slide 14, which shows our geographic revenue mix. In the first half of fiscal year 2023, our revenue was more concentrated than usual in the U.S., primarily due to higher revenue related to radio frequency propagation modeling projects from Tier-1 domestic carriers. Additionally, one customer represented 10% or more of our total revenue in the second quarter and the first half of our fiscal year 2023.

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

Slide 15 details our balance sheet highlights and free cash flow. We ended the second quarter with 367.1 million dollars in cash, cash equivalents, and marketable securities, representing a decrease of 7.5 million dollars since the end of the first quarter of fiscal year 2023. Free cash flow for the quarter was 7.1 million dollars. As a reminder, with regard to share repurchase program activity, we entered into an accelerated share repurchase agreement in our first quarter of fiscal year 2023 to repurchase 150 million dollars of our common stock. We received approximately 70 percent of the total shares estimated to be repurchased pursuant to the ASR agreement in our first quarter, or approximately 3.3 million shares. We anticipate receiving the remaining approximately 30 percent of the program shares when the program concludes, no later than December 31, 2022. From a debt perspective, we ended the second 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 139.1 million dollars, representing a decrease of 9.1 million dollars since March 31, 2022. The DSO metric at the end of the second quarter of fiscal year 2023 was 52 days, versus 64 days at the end of the second 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 last presented during our first quarter fiscal year 2023 earnings call on August 4, 2022. 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. 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 dollars and 3 cents ($2.03).

Second Half FY'23 Outlook

I'd also like to offer some "color" on the second half of our fiscal year 2023. Assuming the mid-point of our revenue outlook range, we currently anticipate that our remaining fiscal year 2023 revenue will be nearly evenly split between our third and fourth quarters, with expectations for our third quarter revenue to be 1 to 2 percentage points higher than our fourth quarter revenue. With regards to the second half earnings per share, assuming the mid-point of our non-GAAP EPS range, we currently anticipate receiving approximately 60 percent in the third quarter and approximately 40 percent in the fourth quarter. As we have discussed previously, our third quarter gross margin will contain a higher product mix of radio frequency propagation modeling project activities, which has a lower gross margin.

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 for Q&A.