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

May 4, 2023

Slide #2: Introduction
Tony Piazza:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's fourth - quarter and full fiscal year 2023 conference call for the period ended March 31, 2023. 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.

Fiscal year 2023 was a strong year for NETSCOUT. We met our top-line and exceeded our bottom-line financial objectives while continuing to advance our strategic priorities to deliver high-value solutions that enable our customers to succeed in today's increasingly complex digital world.

In fiscal year 2023, we delivered another year of total revenue growth, while also expanding operating margin, improving diluted EPS performance, and generating solid free cash flow. On behalf of NETSCOUT, I would like to thank our employees, customers, and other stakeholders who contributed to our success in fiscal year 2023.

Let's now turn to slide number 6 for a brief recap of our non-GAAP financial results in the fourth quarter and full fiscal year 2023, as well as some strategic highlights from the year. Jean will provide more detail on the results later in the call.

Slide #6: Q4 & Full Fiscal Year 2023 Non-GAAP Financial Results

- For the fourth quarter, we delivered revenue of approximately 208 million dollars, up nearly 9 percent year over year, and diluted earnings per share of 38 cents, up more than 30 percent on a year-over-year basis.
- For the full fiscal year 2023, we delivered revenue of approximately 915 million

dollars, representing growth of nearly 7 percent year over year supported by product revenue growth of nearly 10 percent and service revenue growth of more than 4 percent. Our service assurance and cybersecurity product lines both contributed to our revenue growth on a year over year basis with nearly 9 percent and more than one percent revenue growth, respectively.

- We demonstrated strong operating leverage as we delivered two dollars and eighteen cents ($2.18) of diluted earnings per share for the full fiscal year 2023 -- growth of approximately 18 percent year-over-year and more than double that of our revenue growth rate over the same period.
- Finally, during our full fiscal year 2023, we returned approximately 150 million dollars back to our shareholders in the form of an accelerated share repurchase program and generated solid free cash flow of more than 145 million dollars.

In fiscal year 2023, we also advanced several technology initiatives that we expect to contribute to our revenue growth potential in 2024 and beyond and serve as critical building blocks as we deliver on our mission as "Guardians of the Connected World."

One of these advances is the development of the next generation Omnis Cybersecurity solution that builds on learnings from our initial launch, last fiscal year, to better drive customer value. Enhancements to the Omnis Cybersecurity solution include advanced network detection and response capabilities that produce analytics at the source, leverage machine learning, reduce false positives, and provide the ability to operate at greater scale. This allows for better detection, mitigation, and investigation capabilities, through a differentiated approach compared with competing products. We expect the next generation Omnis solution to be a high-value product upsell for existing customers who already use our solutions, trust us, and can enhance their return on investment by adding Omnis to address cybersecurity challenges leveraging their already installed infrastructure. We expect that our enhanced and expanded Omnis offering will be available in the early Summer. We believe we are well positioned to expand our Omnis revenue in the second half of fiscal year 2024.

We also have developed and are launching two new DDoS solutions. First, Dynamic DDoS, which is a solution that adapts to the threat landscape as it evolves and automates the countermeasures used to address cyberattacks, including the latest multi-vector direct path attacks. The second is, Mobile DDoS Security. This solution extends our powerful DDoS capabilities that service providers currently leverage in their wireline networks to now be available to protect their mobile networks to address that distributed threat surface. Like our enhanced Omnis Cybersecurity solutions, these new solutions are expected to increase our Arbor Security revenue in the back half of fiscal year 2024.

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

Slide #7: Market and Business Insights

Service Provider Customer Vertical

In our service provider customer vertical, revenue grew nearly 14 percent year over year for the full fiscal year 2023. This increase was primarily driven by higher revenue than usual related to radio frequency propagation modeling projects from Tier-1 carriers in North America.

Overall, both domestically and internationally, we continue to see carriers invest in their

5G-related network deployments as well as other areas of their businesses. For example, as carriers transition from the propagation planning cycle and initial 5G standalone network buildouts, we believe we are well positioned to further support carriers' needs to monitor their new 5G networks as traffic increases over these networks. Additionally, we believe we are well positioned to expand our business with these carriers in other areas, including their internal IT operations and with our new Mobile DDoS Security solution.

Enterprise Customer Vertical

In our enterprise customer vertical, revenue was relatively flat for the full fiscal year 2023 on a year over year basis. Although enterprises have been under pressure from the macro-economic environment, we continue to believe this customer segment represents attractive growth opportunities for NETSCOUT. As highlighted in our recently published industry reports, enterprises continue to require solutions that better protect their systems and accelerate their digital transformations. We remain focused on helping to address these needs by leveraging our growing suite of comprehensive offerings to provide enterprise customers with an integrated and differentiated platform for service assurance and cybersecurity requirements. By extending visibility to the edges of the network, we help customers cover "blind spots" and address control challenges, facilitating their leverage of off-prem and cloud solutions as part of their digital transformation initiatives and new network architectures.

Michael will provide more insight into our industry research as well as customer wins within our verticals during his remarks.

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

Slide #8: Outlook & Summary

For fiscal year 2024, we remain committed to operating our business with a balanced approach to revenue growth and profitability as we manage the dynamic macro-economic environment. Based on our current view, we expect to continue to grow revenue, improve our margins and diluted EPS performance, and generate solid free cash flow.

We entered the year with solid momentum and anticipate that the opportunities created by extending our core service assurance visibility to cover "blind spots" at the edges of networks created by distributed architectures, as well as our new DDoS offerings, and our next generation Omnis solution will more than offset lower radio frequency propagation modeling project revenue, which was at a high point in fiscal year 2023. Jean will provide the details of our fiscal year 2024 outlook in her remarks.

Longer term, we remain focused on driving toward our business objectives by advancing our strategy to ensure the performance, availability, and security of mission-critical infrastructure for organizations around the globe, anytime, anywhere, as "Guardians of the Connected World." As a trusted brand with more than three decades in business and an advanced service assurance and cybersecurity platform based on scalable deep packet inspection technology, we remain uniquely positioned to help our diverse, primarily Fortune 500 customer base capitalize on major technology trends -- including expanding cybersecurity threats, digital transformation, and 5G network evolution -- and succeed in today's increasingly distributed and complex digital world.

In summary, we are pleased with our fiscal year 2023 performance and excited about the opportunities we see for NETSCOUT in fiscal year 2024 and beyond. We look forward to sharing our progress and achievements with you as the new fiscal year unfolds.

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 remain focused on supporting both our domestic and international carriers as they continue to advance their 5G network buildouts. Additionally, we are expanding our relationships with these carriers beyond their mobile network related requirements by providing solutions for their critical internal IT support infrastructures as well. This evolution demonstrates the value of our powerful solutions, trusted brand, and strong relationships with our customers.

As an example, during the fourth quarter, a long-standing Tier-1 North American carrier customer placed additional orders with us for our service assurance solutions amounting to a low-teens, eight-figure sum. These orders spanned across several of our offerings including: 5G related radio frequency propagation modeling projects, fixed line network monitoring, and internal IT critical business solutions.

Now, turning to our enterprise customer vertical. During the fourth quarter, we received several low-seven-figure orders from both domestic and international government agencies for service assurance and cybersecurity solutions. With the current state of the geopolitical environment, we have seen governments release funding for projects related to intelligence and defense focused initiatives.

As an example, we won brand new business with an international intelligence agency to bring their DDoS detection and mitigation solution on-premises from the cloud to gain direct control of the critical solution. This new customer purchased our DDoS detection and mitigation solutions as well as an on-site engineer to help operate the solution. We won this business in part due to their familiarity with NETSCOUT solutions that were leveraged by their prior provider. We believe there are further opportunities with this customer as they represent other agencies as well. Our ability to win these types of deals and continue to expand our footprint with both new and existing customers is a testament to our strong and reliable offerings, scalability, and brand reputation.

Go-to-Market Activities:

Turning to our go-to-market activities, we remain focused on promoting our industry leadership, trusted brand, and strong solutions through activities that include thought-leadership, marketing, and industry events.

During the quarter, we released our 5th Anniversary DDoS Threat Intelligence Report that shares NETSCOUT's unique insights on the state of security threats and spotlights how our cybersecurity tools are more important than ever. Notably, the report highlights that direct-path attacks surged in 2022, making up half of all DDoS attacks. The report also showed that attack frequencies have increased tenfold since NETSCOUT's first report in 2005.

Additionally, we released new research highlighting the ongoing importance of unified communication and collaboration (UC&C) platforms in the post-pandemic world of hybrid work. In this research, we found that nearly 70% of respondents increased the number of UC&C tools used, with 75% expected to support more platforms over the next 12 months, and the majority indicating that collaboration platforms, applications, and tools are critical to their organization's current work environment. This data validates the growing importance of our service assurance and Smart Edge Monitoring solutions for our customers.

We also continue to actively promote the value of our solutions to our customers by issuing a steady flow of press releases on our major service assurance and cybersecurity solutions which, among other things, articulated the strong return on investment of our solutions, as validated by third parties.

Finally, we continue to attend more in-person events to promote our brand and platform. During our first fiscal quarter, we have or plan to participate in several high-profile events such as the RSA conference, Cisco Live, Dell Technology World, and Big 5G, to name a few. At these events we will interact with potential and existing customers, showcasing the NETSCOUT service assurance and cybersecurity platform, and highlighting our collaboration with many of the conference sponsoring partners' technology platforms.

Thank you, everyone. That concludes my 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 fourth quarter and full fiscal year 2023 and provide some additional commentary on our fiscal year 2024 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: Q4 & Full FY'23 Results

Slide number 12 details the results for the fourth quarter and our full fiscal year 2023. Focusing first on our quarterly performance, total revenue grew 8.8 percent year over year to 208.1 million dollars. Product revenue grew 11.2 percent, and service revenue grew 7.1 percent, both on a year-over-year basis. At the end of the fourth quarter, our "backlog" was approximately 50 million dollars, consisting of approximately 41 million dollars of fulfillable orders and approximately 9 million dollars of radio frequency propagation modeling projects. The majority of the radio frequency propagation modeling amount is reported as deferred revenue in our financial statements. As a reminder, while fulfillable orders can be 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 77.6 percent in the fourth quarter. Quarterly operating expenses increased 3.3 percent year over year, mostly due to the return of "pre-pandemic" activities, such as travel and events. We reported an operating profit margin of 15.7 percent, compared with 12.4 percent in the same quarter last year. Diluted earnings per share was 38 cents, compared with 29 cents in the same quarter last year, representing an increase of 31 percent year over year.

For the full fiscal year 2023, revenue was 914.5 million dollars, which was an increase of 6.9 percent over the prior year. Product revenue grew 9.9 percent and service revenue grew 4.1 percent over the prior year. Gross profit margin was 77.5 percent. Annual operating expenses increased 4.3 percent from the prior year, primarily due to the return of "pre-pandemic" expenses related to the resumption of in person events and travel. We reported an operating profit margin of 22.6 percent, up 1.6 percentage points over the prior fiscal year, with diluted earnings per share of 2 dollars and 18 cents, an 18.5 percent increase compared with the same period in the prior fiscal 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. Please note that all comparisons here are on a year-over-year basis, consistent with our other remarks.

For the fiscal year 2023, our service provider customer vertical revenue grew 13.7 percent, while our enterprise customer vertical revenue grew 0.4 percent. During the same period, our service provider customer vertical accounted for approximately 52 percent of our total revenue, while our enterprise customer vertical accounted for the remaining 48 percent.

Now, turning to our product lines. For the fiscal year 2023, our service assurance revenue increased by 8.9 percent, while our cybersecurity revenue increased by 1.4 percent. During the same period, our service assurance product line accounted for approximately 74 percent of our total revenue, while our cybersecurity product line accounted for the remaining 26 percent.

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

Turning to slide 14, which shows our geographic revenue mix. In fiscal year 2023, our revenue was more concentrated in the U.S. year over year, primarily due to the increase in revenue related to radio frequency propagation modeling projects from Tier-1 domestic carriers. Additionally, in the fourth quarter, no customer represented 10% or more of total revenue, and in the full fiscal year 2023, one customer represented 10% or more of our 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 fourth quarter with 427.9 million dollars in cash, cash equivalents, and short- and long-term marketable securities, representing an increase of 11.7 million dollars since the end of the third quarter of fiscal year 2023. Free cash flow for the quarter was 110.6 million dollars and 146.0 million dollars for the full fiscal year 2023. During the fourth quarter of fiscal year 2023, we repaid 100 million dollars of our revolving credit facility debt and ended fiscal year 2023 with 100 million dollars outstanding on our 800-million-dollar revolving credit facility, which expires in July 2026. We did not repurchase any of our common stock under our share repurchase programs during the fourth quarter. For the full fiscal year 2023, we repurchased a total of approximately 4.6 million shares of our common stock for an aggregate of approximately 150 million dollars through an accelerated share repurchase program. We currently have capacity in our share repurchase authorizations and, subject to market conditions, plan to be active in the market.

To briefly recap our other balance sheet highlights, accounts receivable, net, was 143.9 million dollars, representing a decrease of 4.4 million dollars since March 31, 2022. The DSO metric at the end of the fourth quarter of fiscal year 2023 was 58 days, versus 64 days at the end of the fourth quarter of 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 2024.

FY'24 Outlook

For fiscal year 2024, we currently anticipate revenue in the range of 915 to 945 million dollars, which implies a low single-digit growth rate at the midpoint. Additionally, we currently anticipate delivering approximately 46 to 48 percent of our full year revenue outlook during the first half of the fiscal year, assuming the midpoint of our provided revenue range. The effective tax rate is expected to be between 20 and 22 percent. Assuming approximately 74 to 75 million weighted average diluted shares outstanding, we expect non-GAAP diluted earnings per share to be between 2 dollars and 20 cents ($2.20) and 2 dollar and 32 cents ($2.32).

Q1 FY'24 Outlook

I'd also like to offer some "color" on the first quarter of fiscal year 2024. We currently anticipate revenue to be relatively flat compared to the first quarter of fiscal year 2023 with diluted EPS growing by 4 to 6 cents. This takes into consideration a lower volume of radio frequency propagation modeling project revenue compared to the first quarter of the prior year, as well as reduced marketing expenses as we move our annual ENGAGE user conference from the first quarter last fiscal year to our third quarter of fiscal year 2024 to better align with customers' planning and budgeting cycles.

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.