NETSCOUT SYSTEMS, INC.
First Quarter Fiscal Year 2024 Financial Results Conference Call
Management's Prepared Remarks

July 27, 2023

Slide #2: Introduction
Tony Piazza:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's first-quarter fiscal year 2024 conference call for the period ended June 30, 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, 2023, 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 2024.

Slide #6: Q1 FY'24 Non-GAAP Financial Results

- We delivered solid financial performance in the first quarter of the fiscal year and released several key product offerings since our last earnings call.
- Revenue was 211.1 million dollars, representing year-over-year growth of over 1 percent.
- We expanded both our gross margin and operating margin and grew our diluted EPS by nearly 30 percent year over year to deliver thirty-one cents ($0.31) per diluted share in the period.
- We also accomplished several product milestones, with the release of next-generation solutions that have already been well received by customers and that we expect to start contributing to revenue in the second half of the fiscal year.
    - This includes the release of our "Visibility Without Borders" platform that provides performance, security, and availability across one common data framework. By proactively identifying areas of complexity, fragility, and risk, the platform unlocks insights at unparalleled scale to deliver the intelligence needed to increase visibility, improve agility, and keep data and applications secure.
    - Additionally, we relaunched our Omnis Cyber Intelligence (OCI) solution. This next

generation of OCI is an advanced network detection and response (NDR) solution that uses highly scalable deep packet inspection (DPI) and multiple threat detection methods at the source to detect threats in real time. OCI also applies historical investigation of high-fidelity network metadata and packets. In the face of rising cyber threats, OCI provides security teams with real-time packet-level visibility across their digital infrastructure and helps identify threats earlier in the attack life cycle. OCI also quickens investigations by gathering network-based forensic evidence to reduce the Mean Time to Response (MTTR). OCI is a valuable tool for verifying the effectiveness and improving the existing cybersecurity ecosystem, ensuring compliance, and lowering the risk of successful cyberattacks.

- We also released our two new DDoS solutions:
  - The first is Adaptive DDoS, which helps protect enterprises from rapidly spreading dynamic DDoS attacks. It adapts to the evolving threat landscape and automates countermeasures used to address cyberattacks, including the latest multi-vector direct path attacks.
  - And the second is Mobile Security, which extends our powerful DDoS capabilities that service providers currently leverage in their wireline networks, to now protect their mobile networks and address that distributed threat surface.

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

Slide #7: Market and Business Insights

Enterprise Customer Vertical

Starting with our enterprise customer vertical. In the first quarter of fiscal year 2024, enterprise revenue grew nearly 13 percent year over year, driven by expansion in both our cybersecurity and service assurance businesses. We remain confident that our value proposition of extending visibility to the edges of the network will continue to resonate with enterprise customers seeking to cover "blind spots," address control challenges, and facilitate their leverage of off-premises and cloud solutions as part of their digital transformation and new network architecture initiatives.

Service Provider Customer Vertical

Moving to our service provider customer vertical. As expected, revenue in the first quarter for this vertical declined approximately 9 percent year over year, primarily due to the lower level of radio frequency propagation modeling project revenue in the quarter compared with the same quarter last year. We continue to see domestic and international carriers invest in their 5G deployments. Notably, several carriers now have the spectrum, deployed stand-alone networks in certain markets, and are ready to drive traffic over those networks once 5G required applications materialize. We believe that as 5G adoption advances and 5G traffic volumes increase, our core visibility and cybersecurity solutions will be required. We are prepared and ready to support carriers through this inevitable transition with our differentiated solutions.

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: FY'24 Outlook & Summary

Looking ahead, we remain excited about the market opportunities we are seeing for both our existing and new solutions and are reiterating our fiscal year 2024 outlook. We also continue to see the supply chain challenges that drove the increase in our "fulfillable backlog" resolving and anticipate that fulfillable backlog will continue to return to more normalized levels. We remain focused on operating the business with a balanced approach to driving revenue growth and profitability as we manage through the dynamic macro-environment and position NETSCOUT to deliver long-term sustainable value for our stakeholders as "Guardians of the Connected World." Jean will provide additional color and a recap of the outlook numbers in her remarks.

In summary, we delivered solid first quarter financial results and achieved several product milestones that establish a foundation for delivering our objectives for fiscal year 2024 and beyond. We remain confident that NETSCOUT is well positioned to help customers address the challenges and opportunities of today's digital world through our unique and expanding 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 win highlights in the first quarter.

Slide #10: COO Highlights

Customer Wins:

In our enterprise customer vertical, our proven technology and long, productive partnerships with our install base of customers have always been a strong foundation of our business. As customers continue to adapt, advance, and expand their IT strategies, they continue to depend on NETSCOUT to ensure the success of these transitions. As an example, during the quarter, we won a mid-seven figure service assurance order with a large US regional bank, in support of their datacenter transformation. The opportunity arose from the bank's initiative to upgrade its infrastructure from on-premises to a distributed, co-lo based architecture. NETSCOUT's solutions have been critical to several areas of the bank's business, including on-line banking and Unified Communications call centers. Our long and productive partnership positioned NETSCOUT to win the business, despite the competitive bidding process.

Now, turning to our service provider customer vertical, we remain focused on supporting both our domestic and international carriers' 5G network evolutions. We also continue to support our service providers in their security efforts as cyberattack incidents permeate, and threat surfaces continue to expand.

As an examples from the quarter, on the service assurance front, a long-standing Tier-1 North American carrier customer placed additional orders with us amounting to a mid-seven figure sum as they continue to advance their 5G projects. On the security front, a mid-size international service provider customer placed a low-seven figure order for our Arbor products to upgrade their DDoS protection, replacing a competitor. The main driver for this investment was to deliver a reliable "clean pipe," leveraging an integrated detection and mitigation solution, for their high value customer base. We won the order due to our superior technology, strong reputation, and positive references from the leaders in their sector. These strengths, combined with our recent innovative new product offerings, should continue to drive customer interest in our best-in-class solutions in the rapidly evolving cybersecurity environment.

Go-to-Market Activities:

Turning to our go-to-market activities, we remain focused on promoting our industry leadership, trusted brand, next-generation solutions, and platform.

This included attending several high-profile events such as the RSA conference, Cisco Live, Dell Technology World, and Big 5G. In the second fiscal quarter, we plan to participate in VMware Explore and Black Hat, to name a few.

Looking ahead, NETSCOUT plans to host its customers and partners at our Annual Engage Technology and User Summit from October 2nd to October 5th this year in Orlando, Florida. At Engage 2023, we'll demonstrate how our Visibility Without Borders Platform provides a unified approach to addressing the industry's most pertinent issues, including how performance, security, and availability challenges are multiplying and are often interconnected and overlapping. We'll also highlight our next-generation Omnis Cyber Intelligence solution and our new DDoS products such as Adaptive DDoS and Mobile Security.

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 first quarter of fiscal year 2024 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: Q1 FY'24 Results

Slide number 12 details our first-quarter fiscal year 2024 results. During the quarter, total revenue grew 1.1% percent year over year to 211.1 million dollars. Product revenue declined 3.7% percent and service revenue grew 5.4% percent, both on a year-over-year basis. We ended the first quarter with "backlog" of approximately 16 million dollars, consisting of approximately 12 million dollars of fulfillable orders and approximately 4 million dollars of radio frequency propagation modeling projects. We anticipate that "backlog" will return to historically normalized levels as global supply chain challenges appear to be subsiding and as radio frequency propagation modeling projects have led to the deployment of the 5G infrastructure needed for supporting business and consumer applications.

Our first-quarter fiscal year 2024 gross profit margin was 78.3 percent, up 3.8 percentage points over the same quarter last year. As you may recall, the prior year's quarterly gross margin was impacted by 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 3.6 percent year over year, primarily attributable to increased sales headcount, travel, and events. We reported an operating profit margin of 14.0 percent, compared with 11.7 percent in the same quarter last year. Diluted earnings per share was 31 cents, compared with 24 cents in the same quarter last year, an increase of 29.2 percent year over year.

Slide #13: Q 1 FY'24 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 2024, on a year-over-year basis, our enterprise customer vertical revenue grew 12.9 percent, while our service provider customer vertical revenue declined 9.3 percent. During the quarter, our enterprise customer vertical accounted for 52 percent of our total revenue, while our service provider customer vertical accounted for the remaining 48 percent.

Now, turning to our product lines. In the first quarter of fiscal year 2024, our cybersecurity revenue increased by 9.9 percent and our service assurance revenue declined 2.4 percent, both on a year over year basis. During the first quarter, the service assurance product line represented approximately 69 percent of total revenue, while our cybersecurity product line represented the remaining 31 percent.

Slide #14: Q1 FY'24 Revenue Trends: Geographic Mix

Turning to slide 14, which shows our geographic revenue mix. Compared to last year's first quarter, our revenue was less concentrated in the U.S. due to the prior year's higher radio frequency propagation modeling project revenue. There were no customers representing 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 390.5 million dollars in cash, cash equivalents, marketable securities, and investments, representing a decrease of 37.4 million dollars since the end of fiscal year 2023. Free cash flow for the quarter was a use of 24.3 million dollars. From a debt perspective, we ended the first quarter of fiscal year 2024 with 100 million dollars outstanding on our 800-million-dollar revolving credit facility, which expires in July 2026. 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 108.3 million dollars, a decrease of 35.6 million dollars since March 31, 2023. The DSO metric at the end of the first quarter of fiscal year 2024 was 44 days, in line with the end of the first quarter of fiscal year 2023, and a decrease from 58 days at the end of our fiscal year 2023.

Slide #16: FY'24 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

As Anil noted earlier, we are reiterating our non-GAAP outlook for fiscal year 2024 that was presented during our May 4, 2023, fourth quarter and full fiscal year 2023 earnings call. As a reminder, for fiscal year 2024, we continue to anticipate revenue in the range of 915 to 945 million dollars, which implies a low single digit growth rate at the midpoint of the range. The effective tax rate is anticipated to be in the range of 20 to 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 dollar and 20 cents ($2.20) and 2 dollar and 32 cents ($2.32), which implies a mid-single digit growth rate, at the midpoint of the range.

1H FY'24 Outlook

I'd also like to offer some "color" on the first half of fiscal year 2024. At the midpoint of our full fiscal year 2024 outlook ranges, we continue to anticipate delivering approximately 46 to 48 percent of our full fiscal year revenue outlook during the first half of the fiscal year. We also anticipate delivering mid-single digit diluted EPS growth for the first half of the fiscal year, 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.