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

November 2, 2023

Slide #2: Introduction
Tony Piazza:

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

We delivered second-quarter revenue in line with our preliminary results announced in mid-October. Revenue was impacted by a slowing in order conversion late in the second quarter related to industry and economic headwinds that we expect will persist into the second half of fiscal year 2024. In response to these dynamics, we initiated several actions to manage discretionary costs, which more than offset the bottom-line impact in the second fiscal quarter and should reduce the negative impact to our full fiscal year earnings per share outlook without compromising our longer-term objectives. We will provide more information on these market dynamics affecting our business as we review our performance and outlook.

Let's turn to slide number 6 for a brief recap of our non-GAAP financial results for the second quarter and first half of our fiscal year 2024.

Slide #6: Q2 and 1H FY'24 Non-GAAP Financial Results

- For the second quarter, financial results were in-line with our preliminary expectations released on October 16th :
  - Revenue for the quarter was 196.8 million dollars, down 13.7 percent year over year, due to the previously mentioned order conversion slowdown related to the industry and economic environment impacting our customers as well as a lower level of radio frequency propagation modeling project revenue compared to the prior year.
  - Despite the revenue decline, we delivered diluted earnings per share for the quarter

of sixty-one cents ($0.61), an increase of seven percent year over year, as we benefited from several discretionary cost saving actions that we initiated in response to the current environment.

- For the first half of the fiscal year, or the period ended September 30, 2023,
  - Revenue for the first half was 407.9 million dollars, down 6.6 percent year over year, primarily for the reasons stated earlier that impacted our second fiscal quarter revenue.
  - The corresponding diluted earnings per share of ninety-two cents ($0.92), was an increase of 13.6 percent year over year, which again, benefited from the actions taken during our second fiscal quarter.
  - Finally, for the first half of the fiscal year, our cybersecurity revenue grew approximately 10 percent year over year, due to growth in both our core DDoS and our newer Omnis solutions, as customers prioritized spending on security solutions. This was more than offset by a decline of approximately 13 percent year over year in our service assurance revenue, due to the reasons we mentioned earlier. Excluding radio frequency propagation modelling project revenue from the comparison, service assurance revenue declined approximately 8 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

Enterprise Customer Vertical

Starting with our enterprise customer vertical. In the first half of fiscal year 2024, enterprise revenue declined approximately 3 percent year over year, as growth in our cybersecurity product line revenue was more than offset by a decline in our service assurance product line revenue.

Toward the end of the second quarter, our order flow through rates began to be affected by higher spending scrutiny and delayed project funding as customers navigated the evolving and challenging macroeconomic environment. This resulted in sub-pockets of softness across multiple enterprise sectors as deals were delayed or reevaluated, most notably in the financial and healthcare sectors, which were partially offset by growth in the government sector.

Despite the current economic environment, we remain confident that our value proposition of providing enhanced cybersecurity solutions and extending visibility to the edges of the network will continue to resonate with enterprise customers as they seek to protect their networks from attack, 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. Revenue in the first half of the fiscal year declined approximately 11 percent year over year, which was primarily attributable to a lower level of radio frequency propagation modeling project revenue. Excluding radio frequency propagation modeling project revenue from the comparison, the service provider customer vertical revenue declined approximately 3 percent year over year, as revenue growth in our cybersecurity product line, driven by the prioritization of security solution spending, was more than offset by a decline in our core service assurance product line revenue.

Revenue in this vertical was also impacted by a slowing in demand flow-through late in the second quarter, as higher spending scrutiny and delayed project funding was observed, likely due to the well-publicized capital spending constraints impacting service providers. Notably, most of the order delays in this vertical related to cable and international service providers. We anticipate North American service providers will follow a similar pattern in the second half of the fiscal year given recent news and customer interactions, which is reflected in our updated outlook.

Despite the industry challenges in this vertical, we believe that as 5G adoption accelerates, new use cases advance, and 5G traffic volumes increase, our core visibility and cybersecurity solutions will be increasingly required. We remain 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

We adjusted our fiscal year 2024 outlook to account for the changed market environment. We reduced our revenue outlook by 80 million dollars, assuming the midpoints of our original and updated revenue outlook ranges. This represents a combination of both service provider and enterprise related opportunities in our pipeline that we believe may be delayed or revisited due to current industry and economic headwinds as deals are increasingly scrutinized and take longer to close. We originally expected these opportunities, as well as other factors, to more than offset the approximately 60 million dollars of lower radio frequency propagation modeling project revenue anticipated year over year. As I mentioned earlier, we took immediate actions to prudently manage costs, such as curtailing hiring, eliminating certain programs and events, and adjusting variable incentive compensation, to reduce the negative impact to our full fiscal year earnings per share outlook without compromising our longer-term objectives. Jean will provide a recap of the outlook in her remarks.

Looking ahead, we are committed to delivering results in-line with our updated outlook as we continue to execute on our strategic priorities and position NETSCOUT to deliver long-term stakeholder value. Despite the near-term headwinds, we believe that the longer-term demand trends driving our business remain intact as enterprises and service providers continue to require cybersecurity and service assurance solutions that deliver actionable visibility at scale. With our industry leading 'Visibility Without Borders' platform, strong customer relationships, and solid financial profile, we remain well-positioned to play a critical role in enabling our customers to tackle the performance, availability, and security challenges of the increasingly complex connected 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 win highlights in the second quarter.

Slide #10: COO Highlights

Customer Wins:

In our enterprise customer vertical, we experienced several deals where customers purchased across our platform of solutions, a trend we are seeing more of, which we believe validates the power of NETSCOUT's unified portfolio and supports our strategy. For example, a federal agency placed multi-solution orders totaling mid-seven figures with us in the second quarter. These orders consisted of solutions across our service assurance, availability, and security product portfolio, within which our Omnis solution was a significant portion of this order. We have a long-standing relationship with this customer and our proven technology and historical performance continues to win us repeat business as they deploy our new and legacy solutions more broadly within their organization.

Now, turning to our service provider customer vertical, we remain focused on supporting carriers' 5G network evolutions as well as their security efforts, as cyberattack incidents accelerate, and threat surfaces continue to expand. We continue to see carriers invest in 5G and other areas, albeit at a slower pace and through smaller order sizes, given the current environment. During the second quarter, a long-standing, Tier-1 North American carrier customer placed follow on orders with us amounting to high-seven figures. These orders were for our service assurance solution, for both their mobile network, related to 5G and the radio access network, as well as for their business IT systems. We remain excited about continuing to broaden our relationship with this customer as a trusted partner across their organization and network ecosystem.

Go-to-Market Activities:

Turning to our go-to-market activities,

Since our last earnings call, we announced several product advancements. This included the release of Adaptive DDoS for our Threat Mitigation System and RAN Analytics for Carrier Aggregation. Additionally, we revealed a recent total economic impact study, completed by Forrester Consulting, which found that our Arbor DDoS protection solution delivered a return on investment of over 200% during the study period. We also announced that we achieved Amazon Web Services (AWS) Security Competency for our advanced NDR product, Omnis® Cyber Intelligence (OCI), in the category of threat detection and response. In addition, we issued our 1H2023 Threat Intelligence Report, highlighting the continued rise in cybercriminal activities. The report revealed that approximately 7.9 million DDoS attacks took place in the first half of the year, a 31% increase year over year. We also issued our latest Environmental, Social, and Governance report demonstrating our progress in this important area.

Finally, in early October we hosted our customers and partners at our Annual ENGAGE Technology and User Summit in Orlando, Florida. It was another successful event, which included a combination of presentations, panel discussions, solution demonstrations, and hands-on trainings. Registration and attendance increased more than 50 percent year over year, demonstrating strong interest and loyalty among our users. During the event, we showcased our "Visibility Without Borders" Platform and how it provides a unified approach to addressing the industry's most pertinent issues – an important value proposition as the performance, availability, and security challenges of the industry are multiplying and are often interconnected and overlapping. At the event, we also announced our next-generation data export technology targeted at AIOps solutions running on advanced analytics platforms and data lakes to expand our "smart data" footprint.

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 second quarter and first half 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: Q2 and 1H FY'24 Results

Slide number 12 details our results for our second quarter and first half of fiscal year 2024. Focusing on quarterly performance, total revenue declined 13.7 percent year over year to 196.8 million dollars. Product revenue declined 28.0 percent and service revenue was flat, both on a year-over-year basis.

Our second-quarter fiscal year 2024 gross profit margin was 80.3 percent, up 3.5 percentage points over the same quarter last year. The increase was primarily attributable to lower levels of radio frequency propagation modeling project costs this quarter compared with last year and a reduction in variable incentive compensation. As a reminder, radio frequency propagation modeling projects tend to have significantly lower gross margin than our other products due to the labor-intensive nature of those projects. Quarterly operating expenses decreased 15.1 percent year over year, primarily related to cost reductions associated with variable incentive compensation and events. We reported an operating profit margin of 28.0 percent, compared with 23.7 percent in the same quarter last year. Diluted earnings per share was 61 cents, compared with 57 cents in the same quarter last year, an increase of 7.0 percent year over year as we took the actions previously mentioned to offset the impact of the revenue decline.

Finally, I wanted to note that in the last month of the second quarter we divested the Test Lab Automation portion of our Test Optimization business to Spirent for approximately 8 million dollars. This business was not material to NETSCOUT's overall financial profile nor strategic to the Company's core offerings. We believe that the sale to Spirent places the business with a better aligned owner. From a performance standpoint, the Test Optimization revenue contribution year to date was approximately 6 million dollars, and we expect its absence to be a headwind of approximately this same level in year over year comparison in fiscal year 2025.

Slide #13: 1H 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 half of fiscal year 2024, on a year-over-year basis, our enterprise customer vertical revenue declined 2.9 percent, while our service provider customer vertical revenue declined 10.6 percent. During the first half of the fiscal year, our enterprise customer vertical accounted for 53 percent of our total revenue, while our service provider customer vertical accounted for the remaining 47 percent.

Now, turning to our product lines. In the first half of fiscal year 2024, our cybersecurity revenue increased 10.4 percent, while our service assurance revenue decreased 13.1 percent, both on a year over year basis. During the first half of the fiscal year, our service assurance product line represented approximately 68 percent of total revenue, while our cybersecurity product line represented the remaining 32 percent.

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

Turning to slide 14, which shows our geographic revenue mix. In the first half of the fiscal year, 60 percent of our revenue was derived from the United States, with the remaining 40 percent provided by international markets. The mix between domestic and international markets shifted from the same period last year partially due to lower Tier-1 domestic carrier radio frequency propagation modeling project revenue this fiscal year. Also, no customers represented 10% or more of our total revenue in the second quarter or for the first half of the fiscal year.

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 332.6 million dollars in cash, cash equivalents, short and long-term marketable securities, and investments, representing a decrease of 95.3 million dollars since the end of fiscal year 2023. Free cash flow for the quarter was a use of 27.9 million dollars. During the second quarter, we repurchased a total of approximately 1.1 million shares of our common stock for an aggregate purchase price of approximately 31.2 million dollars or an average price of 27 dollars and 90 cents ($27.90) per share. From a debt perspective, we ended the second quarter of fiscal year 2024 with 100 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 152.6 million dollars, an increase of 8.7 million dollars since March 31, 2023. The DSO metric at the end of the second quarter of fiscal year 2024 was 69 days, versus 52 days at the end of the second quarter of fiscal year 2023 and 58 days at the end of our fiscal year 2023. The higher DSO metric was due to the timing and composition of bookings.

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 updated our fiscal year 2024 outlook on October 16, 2023. For the full fiscal year 2024, we now anticipate revenue in the range of 840 million to 860 million dollars. 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 impact of our second quarter share repurchase activity, we expect non-GAAP diluted earnings per share to now be between 2 dollar and 00 cents ($2.00) and 2 dollar and 20 cents ($2.20).

Q3 FY'24 Outlook

I'd also like to offer some "color" on the third quarter of the fiscal year. Starting with revenue. As Anil mentioned, the deals in the pipeline may take longer to close given the environment. They may also be impacted by the timing of customer budget cycles based on the calendar year end. Therefore, we anticipate approximately 23 to 24 percent of the 850-million-dollar mid-point of our revenue outlook could take place in the third quarter. With regard to diluted earnings per share, third quarter EPS will be impacted by the anticipated timing of revenue as well as the cost of our ENGAGE event, which took place in the third quarter of fiscal year 2024, versus historically occurring in our first fiscal quarter. As a result, we anticipate third quarter EPS to be approximately 17 to 18 percent of the 2 dollar and 10 cent mid-point of our EPS outlook.

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.