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

January 25, 2024

Slide #2: Introduction
Tony Piazza:

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

At a high level, we delivered third quarter revenue and non-GAAP EPS ahead of expectations due to the timing of customer year-end budget spending and our continued cost containment efforts. However, the macro environment remains challenging with constrained customer spending and elongated sales cycles. We continue to see strength in our cybersecurity business, where we delivered double-digit revenue growth during the first nine-months of fiscal year 2024. Our service assurance business continues to face headwinds, primarily due to the Tier-1 U.S. carriers' capital constrained environment. Accordingly, our enterprise customer vertical was relatively flat for this period, while our service provider customer vertical is creating the majority of the revenue pressure. Given the macro dynamics, we anticipate delivering full fiscal year 2024 revenue at the low-end of our previously disclosed outlook range, while our cost containment efforts and other activities should position us to deliver non-GAAP EPS for the full fiscal year at the higher end of our previously disclosed outlook or relatively in-line with last fiscal year's EPS, on a lower revenue base year over year. We will provide more specifics during our remarks.

With that as a backdrop, let's turn to slide number 6 for a brief recap of our non-GAAP financial results for the third quarter and first nine months of our fiscal year 2024.

Slide #6: Q3 and YTD FY'24 Non-GAAP Financial Results

- For the third quarter of fiscal year 2024,

  - Revenue was ahead of our expectations at approximately 218 million dollars, due to the timing of customer year-end budget spending. On a year over year basis, this was down approximately 19 percent, as growth in the cybersecurity product line only partially offset a decline in the service assurance product line for the reasons previously mentioned.
  - Non-GAAP diluted earnings per share for the quarter was seventy-three cents ($0.73), which exceeded our expectations due to higher revenue and lower costs than we previously anticipated. This was a decrease of twenty-seven percent year over year, primarily related to lower revenue, partially offset by continued cost containment efforts and other activities.

- For the first nine months of fiscal year 2024, or the period ended December 31, 2023,
  - Revenue was 626 million dollars, down approximately 11 percent year over year.
  - During this period, our cybersecurity revenue grew more than 13 percent but was more than offset by a service assurance revenue decline of approximately 20 percent, both on a year over year basis. Excluding radio frequency propagation modeling project revenue from the comparison, service assurance revenue declined approximately 13 percent year over year.
  - Non-GAAP diluted earnings per share for the first nine months was one dollar and sixty-five cents ($1.65), down approximately 9 percent year over year as the impact of lower revenue was partially offset by cost containment efforts and a lower share count.

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 nine months of fiscal year 2024, enterprise revenue was essentially flat year over year, as revenue growth in our cybersecurity product lines offset a mid-single digit percentage decline in our service assurance product line revenue.

In the enterprise market, flow through rates continued to be affected by higher spending scrutiny and delayed project funding as customers navigated the current macroeconomic environment. However, some sectors grew year to date, such as government and financials, while others, like the healthcare sector, were notably softer.

We expect our enhanced cybersecurity solutions and ability to extend visibility to the edge will continue to resonate with our customers. These solutions help protect customers' networks from attack, cover "blind spots," address control challenges, and facilitate their leverage of off-premises and cloud solutions within digital transformation and new network architecture initiatives.

Service Provider Customer Vertical

Moving to our service provider customer vertical. Revenue in the first nine months of the fiscal year declined approximately 22 percent year over year. Excluding radio frequency propagation modeling project revenue from the comparison, the service provider customer vertical revenue declined approximately 13 percent year over year, as revenue growth in our cybersecurity product line was more than offset by a decline in our core service assurance product line revenue.

The service provider market remains challenging, especially for the U.S. Tier-1 service providers given capital spending constraints, which is causing intense spending scrutiny and delayed project funding. This dynamic appears to be impacting the finalization of carriers' new calendar year budgets and funding as well. We expect the challenging market dynamics to persist for the remainder of the fiscal year and likely into next fiscal year. However, 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.

Despite the current selling environment, we are encouraged by the interest in our new offerings, like Omnis, and recent traction with our other cybersecurity solutions, particularly our DDoS offerings, including Adaptive DDoS and Mobile Security.

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, taking into consideration the current environment, for the full fiscal year 2024 we expect revenue will be at the low end of our previously disclosed revenue outlook range, or approximately 840 million dollars. We anticipate delivering non-GAAP EPS at the higher end of our previously disclosed EPS outlook range as we continue to benefit from our cost containment efforts and other activities. This would put our non-GAAP EPS relatively in-line with last fiscal year's EPS, on lower revenue year over year. Jean will provide a recap of the outlook in her remarks.

Despite the continuation of near-term headwinds, we believe that fundamental longer-term demand trends remain intact for NETSCOUT as enterprises and service providers require industry-leading cybersecurity and service assurance solutions such as ours to deliver actionable visibility at scale. Accordingly, we remain focused on leveraging our industry leading "Visibility Without Borders" platform to help customers tackle the performance, availability, and cybersecurity challenges of the increasingly complex connected digital world. We expect the continued execution of this strategy will enable us to deliver sustainable value for our shareholders.

We look forward to sharing our progress with everyone at the conclusion 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 third quarter.

Slide #10: COO Highlights

Customer Wins:

In our enterprise customer vertical, during the quarter we displaced a competitor to win a low-seven figures order from a leading domestic insurance company, which is a new logo for us. The opportunity related to our service assurance solutions needed to address datacenter and hybrid cloud visibility. We won this deal due to our superior technology that addressed incumbent vendor shortfalls and our strong reputation as an industry leader. We believe there are more opportunities on the horizon to support this new customer with further service assurance deployments as well as potential cybersecurity solutions, given strong explicit interest in this area as well.

Turning to our service provider customer vertical, a Tier-1 European carrier renewed a multi-year agreement with us and placed a mid-seven figure order that included both service assurance solutions to advance their 5G network evolution as well as cybersecurity solutions. The order included our recently released Mobile Security solution that leverages our innovative MobileStream and Sightline offerings to detect DDoS attacks on the mobile network, a product derived from our market-leading solution generally deployed in the fixed line network. We won this opportunity due to our proven technology and strong, long-standing incumbent relationship with this customer. As we advance this new Mobile Security solution, we are encouraged by the high interest in this offering as we are actively engaged in multiple deal discussions in addition to a handful of trials across the service provider landscape.

Go-to-Market Activities:

Turning to our go-to-market activities, recently we announced the launch of Adaptive DDoS for Arbor Edge Defense (AED) to protect ISPs and enterprises from so called DNS water torture attacks as we enhance our solutions with our new technologies. Additionally, we plan to attend Mobile World Congress (MWC) in Barcelona in late February, where we will be meeting with existing and prospective customers. Our focus will be on sharing our latest service assurance, AI/ML analytics, and cybersecurity solutions related to 5G network visibility and cybersecurity requirements.

That concludes my remarks. Thank you, everyone. I will now turn the call over to Jean for a review of our financial results.

Slide #11: CFO Review

Jean Bua:

Thank you, Michael, and good morning, everyone. I will review key metrics for our third quarter and first nine months 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: Q3 & YTD FY'24 Results

Slide number 12 details the results for the third quarter and first nine months of our fiscal year 2024. Focusing first on our quarterly performance, total revenue was 218.1 million dollars, down 19.1 percent year over year. Product revenue was 95.8 million dollars, a decrease of 35.9 percent, while service revenue was 122.2 million, up 1.8 percent, both on a year-over-year basis.

Gross profit margin was 81.8 percent in the third quarter, up 1.3 percentage points year over year, primarily attributable to higher service revenue and lower variable incentive compensation expense as compared to last fiscal year. Quarterly operating expenses decreased 5.2 percent year over year, primarily due to cost containment efforts including reduced variable incentive compensation. Operating expenses for the quarter included our ENGAGE User and Technology Event which had historically occurred in our first quarter. We reported an operating profit margin of 29.0 percent, compared with 35.5 percent in the same quarter last year. Diluted earnings per share was seventy-three cents, compared to 1 dollar in the same quarter last year.

Slide #13: Y T D FY'24 Revenue Trends: Customer Verticals & Product Lines

Turning to slide 13, I will 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 nine months of fiscal year 2024, our enterprise customer vertical revenue was effectively flat. Our service provider customer vertical revenue decreased 22.1 percent. During the same period, our enterprise customer vertical accounted for approximately 54 percent of our total revenue, while our service provider customer vertical accounted for the remaining 46 percent.

Turning to our product lines. For the first nine months of fiscal year 2024, our cybersecurity revenue increased by 13.5 percent, while our service assurance revenue decreased by 19.7 percent. During the same period, our service assurance product line accounted for approximately 68 percent of our total revenue, while our cybersecurity product line accounted for the remaining 32 percent.

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

Turning to slide 14, this shows our geographic revenue mix. In the first nine months of fiscal year 2024, 59 percent of our revenue was derived from the United States, with the remaining 41 percent provided by international markets. As expected, 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 customer represented 10% or more of our total revenue in the third quarter or for the first nine months 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 third quarter with 330.1 million dollars in cash, cash equivalents, short- and long-term marketable securities, and investments, representing a decrease of 2.5 million dollars since the end of the second quarter of fiscal year 2024. Free cash flow for the quarter was 12.7 million dollars. During the third quarter, we repurchased a total of approximately 706 thousand shares of our common stock for an aggregate purchase price of approximately 18.8 million dollars or an average price of 26 dollars and 66 cents ($26.66) per share. From a debt perspective, we ended the third 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 other balance sheet highlights, accounts receivable, net, was 221.6 million dollars, representing an increase of 77.7 million dollars since March 31, 2023. The DSO metric at the end of the third quarter of fiscal year 2024 was 90 days, versus 69 days at the end of the third quarter of fiscal year 2023 and 58 days at the end of fiscal year 2023. The higher DSO metric in the third quarter of this fiscal year 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 are updating our outlook for fiscal year 2024, which was last presented on November 2, 2023, during our second quarter fiscal year 2024 earnings call.

We now anticipate revenue to be approximately 840 million dollars, at the lower end of our previously disclosed range. We anticipate non-GAAP diluted earnings per share to now be within the range of 2 dollars and 15 cents ($2.15) to 2 dollars and twenty cents ($2.20). This is toward the upper end of our previously disclosed range, as we benefit from continued cost management efforts as well as a lower tax rate and share count. The effective tax rate is expected to be at the lower end of our range of 20 to 22 percent as we finalize the tax impacts related to legislation associated with the capitalization of R&D costs. Our weighted average diluted shares outstanding is assumed to be between 72 and 73 million shares, which includes the impact of our recent share repurchase activity.

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.