



**NETSCOUT SYSTEMS, INC.**  
**Third-Quarter Fiscal Year 2021 Financial Results Conference Call**  
**Management's Prepared Remarks**

**January 28, 2021**

**Tony Piazza: Introduction**

Thank you, operator, and good morning everyone. Welcome to NETSCOUT's third-quarter fiscal year 2021 conference call for the period ended December 31, 2020. 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](http://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. These statements may be prefaced by words such as "anticipate," "believe," and "expect" and will cover a range of topics that are not strictly historical facts such as our outlook, our market opportunities and market share, key business initiatives and future product plans, along with their potential impact on our financial performance. 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, which are described on this slide, in today's financial results press release, as well as in the Company's Annual Report on Form 10-K for the year ended March 31, 2020

and subsequent quarterly reports on Form 10-Q. 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 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 are available 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. Good morning everybody and thank you for joining us. Let's begin on slide number 6 with a brief recap of our third-quarter non-GAAP results.

## **Slide #6: Q3'21 Financial Results**

- We are generally pleased with our third-quarter results. They contributed to our strong year-to-date earnings per share growth over the same period in the prior fiscal year.
- Revenue for the quarter was 228.7 million dollars.
- Earnings per share was 66 cents in the quarter.
- The quarter had solid gross and operating margins of 78.6 percent and 28.2 percent, respectively. This was attributable to high-margin security product performance and reduced expenses from our continued cost control focus and benefits from pandemic related restrictions on travel and events.
- Today we are narrowing our revenue range and increasing our EPS outlook as a result of our year-to-date performance.

Let's move to slide 7 for some further perspective on market trends and business insights.

## **Slide #7: Market Trends and Business Insights**

From a market perspective, our offerings are being well received given our ability to provide service assurance, with real-time, pervasive visibility and insight. Our security solutions mitigate disruption for our customers, and all of our products provide solutions regardless of the customer's underlying infrastructure. This is important as customers further safeguard their

Information Technology infrastructure in this pandemic environment that is straining networks in terms of volume and attempted security breaches. Despite these needs, it continues to be a challenging selling environment as many companies are financially constrained as they manage through the current pandemic and macro-economic environment and are forced to make tough choices on balancing visibility and protection against spending constraints.

*Service Provider Customer Vertical*

In the service provider customer vertical, revenue declined approximately 11 percent for the quarter and approximately 9 percent on a year-to-date basis. We do not see any immediate changes to the service provider spending environment but are optimistic about 5G given the recent spectrum auctions.

As we have discussed on prior calls, the next technology evolution that we believe will create increased customer spending in this vertical is 5G, and specifically, the buildout of the “standalone” 5G networks. Although we are not at the “standalone” 5G network point yet, we are starting to see progress on this front. The conclusion of the FCC U.S. auction process for the C-Band spectrum required to advance the “standalone” 5G networks saw record-breaking prices. Bidders are currently awaiting their spectrum allocations which should be a catalyst to advancing the build-out of “standalone” 5G networks in the U.S.

Michael will highlight some recent customer wins in this vertical during his remarks.

### *Enterprise Customer Vertical*

In the enterprise customer vertical, revenue declined approximately 13 percent for the quarter and approximately 4 percent on a year-to-date basis. The primary driver of the year-to-date decrease was lower federal government spending. As we have previously mentioned, even with a solid pipeline of user-approved projects in the federal government sector, the timing and magnitude of funding for these initiatives has been difficult to predict in the current environment. Removing federal government revenue from the comparison, enterprise revenue would have grown in the low-to-mid single-digits on a year-to-date basis.

Given the heightened awareness around cyber security from the pandemic and recent news of the Sunburst Attack, I would like to take a moment to frame our security product line. Our security offerings, in particular our Smart DDoS solutions, have done well this year. Our year-to-date security revenue growth is in the low-double-digits, with growth in both the service provider and enterprise verticals compared to the same period last fiscal year. Our security offerings currently make up approximately a quarter of our total annual revenue.

From a competitive perspective, our security offerings are differentiated in that they are driven by broad and deep visibility that illuminates our customers' network infrastructures using patented NETSCOUT packet and flow processing technologies and our unique intelligence. We also focus in two areas: speed of detection from the network to the application layer; and fast access to forensic capabilities that allow our customers to quickly understand what happened during any incident. Most importantly, our products have delivered against the requirements of the most demanding organisations all around the world.

We are increasing our focus in the security area as we continue to integrate our service assurance and security solutions to provide these unique offerings in the market. For example, we recently released two new products, Cyber Investigator and CyberStream, which combine our packet-based technologies and are designed to accelerate threat hunting, forensics, and incident response. Our AED product is designed to catch and block an attack and Cyber Investigator/CyberStream provide insight into the minds of the hackers.

Michael will highlight more on this and some of our enterprise wins in this vertical during his remarks.

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

### **Slide #8: Outlook & Summary**

Our focus during these challenging times has been to keep our team safe and productive, to serve our customers well with the highest quality solutions and service, and to drive overall margin expansion while preserving liquidity to maintain a strong balance sheet and financial flexibility.

Our relevant solutions, trusted brand, strong customer relationships, dedicated team, and solid financial profile have positioned us well as we continue to weather the current environment. That said, we are not immune to the impacts of the pandemic and resulting challenging macro-economic environment that is causing elongated purchasing cycles. In the face of this climate, we remain committed to enhancing our profitability. Today, we are raising

our fiscal year 2021 earnings per share outlook given our solid year-to-date earnings performance. With one quarter remaining in our fiscal year 2021, we are also narrowing our annual revenue guidance range, although the mid-point remains the same. Jean will provide more details on our updated guidance during her remarks.

We appreciate the dedication and support of our employees and other stakeholders during this time. We also look forward to interacting with many of our users and partners at our upcoming virtual Engage 2021 Technology and User Event. Michael will provide more information on this event during his remarks. With long-term market trends, such as digital transformation, cloud migration, increased cyber threats, and 5G networks, in NETSCOUT's favor, we continue to believe we are well-positioned as "Guardians of the Connected World" when we emerge from this global crisis.

I look forward to updating you on our progress as we finish this fiscal year and sharing our strategy for fiscal year 2022 and beyond on a future call.

I'll now turn the call over to Michael for his remarks.



## **Slide #9: COO Update**

### **Michael Szabados:**

Thank you, Anil, and good morning everyone. Slide 10 outlines the areas I will cover.

#### ***Customer Wins:***

Starting with customer wins in the service provider vertical, a notable win in the quarter was one with a tier-1 domestic mobile service provider that continues to build on our solutions as it rolls out its 5G network. The deal was a low-8 figure order similar to the order they placed in the same quarter last year. The deal encompassed our entire software portfolio of service assurance solutions and is a key part of this providers 5G offering.

Continuing with the service provider vertical, from a security perspective, we see additional opportunities emerging for our security products due to the strong increase in OTT (over-the-top) traffic. During the quarter, we won a mid-seven figure deal with an existing customer that is a leading MSO (Multi-Services Operations) company. They began an initiative to place DDoS protection at the subscriber edge of their network, beyond the typical placement at the so-called "peering" edge, to optimize traffic flow and offer managed services to their customers from these installations.

Smart DDoS opportunities are growing due to the new, more sophisticated, and complex attack types that necessitate on-premises deployments in the enterprise market, often in front of the customers' firewall, to protect them from being overrun by high-volume attacks. Our AED product has benefitted from this trend.

In the enterprise vertical, new logos are often competitive wins against an incumbent and in some cases the opportunity arises in greenfield accounts due to growing threats to mission-critical services. Such was the case with a low-seven-figure deal in Asia, where the customer is the back-office service provider to a leading U.S. bank, which is a long-standing customer of ours. In this situation, we sold at the CTO level and could address both their service assurance and DDoS protection requirements with a combination of our nGenius and Smart DDoS security solutions. Increasingly, in our enterprise wins, our superior portfolio breadth and depth are the deciding factor in our favor.

A sector that has continued to perform well in our enterprise customer base in this environment is healthcare. During the quarter, we won a series of deals that amounted to a high-seven figure total with a leading U.S. healthcare provider, who is a longstanding customer. The transaction was a refresh and expansion of their existing service assurance deployments at various sites. This refresh was an opportunity to convert their appliance deployments to our COTS offering which was a financially compelling value to the customer. Expansion opportunities have been developing in cloud initiatives, telemedicine, and application assurance.

***Go-to-Market Activities:***

On the go-to-market front, we continue to focus on our strategic partnerships and customer engagement.

One example of a key partnerships is with Amazon Web Services. In November, we exhibited at the AWS annual re:invent 2020 event and announced and demoed NETSCOUT

Cyber Investigator in the cloud. Cyber Investigator is also available in all other form factors and is designed to accelerate threat hunting and investigation, as Anil mentioned. We collaborated closely with AWS in their development of pioneering packet access services, which enable packet-based security and service assurance vendors to deploy their solutions simply and affordably in the cloud.

On the customer engagement front, we are planning our annual Engage Technology and User Summit as a virtual event scheduled for April 19<sup>th</sup> through April 30<sup>th</sup>. For Engage 2021, we are expanding the event to attract both users and prospects, in both the service assurance and cyber security fields. Over the two weeks, we will showcase our Security, Service Assurance and DDoS capabilities through presentations, panel discussions, demonstrations, and hands-on training. This event is an annual tradition and a highlight of the year for us, given the opportunity to meet with our user and partner community and discuss how our solutions truly offer Visibility Without Borders.

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 third quarter and first nine months of our fiscal year 2021 performance, along with our guidance for the remainder of the fiscal year. 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.

## **Slide #12: Q3 and First Nine Months FY'21 Results**

Slide number 12 details our results for our third quarter and year-to-date fiscal year 2021. Focusing on the quarterly performance, revenue declined 12.0 percent over the same quarter in the prior year to 228.7 million dollars. Product revenue declined 19.8 percent and service revenue declined 2.6 percent over the prior year's quarter.

Our third-quarter fiscal year 2021 gross profit margin was 78.6 percent, up 0.8 percent over the same quarter last year primarily attributable to the product mix within the quarter. Our "software only" sales were 31 percent of service assurance product revenue compared with 42 percent in the third quarter of the prior year. Quarterly operating expenses decreased 12.1 percent from the prior year, reflecting continued cost controls and reduced cost for sales and marketing and pandemic related travel restrictions. We reported an operating profit margin of 28.2 percent compared with 27.3 percent in the same quarter last year. Diluted earnings per share was 66 cents compared with 73 cents in the same quarter last year.

**Slide #13: First Nine Months YTD FY'21 Revenue Trends: Customer Verticals**

Turning to slide 13, I'd like to review key revenue trends for the first nine months of the fiscal year. At the end of our fiscal third quarter, the service provider customer vertical revenue declined approximately 9 percent while the enterprise vertical declined approximately 4 percent.

Approximately 51 percent of total revenue for the first nine months of the fiscal year was generated by the service provider vertical, with the remainder in the enterprise vertical.

**Slide #14: First Nine Months YTD FY'21 Revenue Trends: Geographic Mix**

Turning to slide 14, which shows our geographic revenue mix, on a GAAP basis. Revenue by geography was 59 percent in the United States and 41 percent internationally. There were no customers in the quarter or the first nine months of the year that represented 10% or more of revenue.

**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 cash, cash equivalents, short-term marketable securities, and long-term marketable securities of 490.4 million dollars, which is an increase of 62.6 million dollars since the end of the second quarter. Free cash flow generated in the quarter was 62.0 million dollars. During the quarter we repurchased approximately 154 thousand shares of our common stock at a cost of approximately 3.3 million dollars which is an average price per share of 21 dollars and 23 cents. We currently have a share repurchase program in place and plan to be active in the market depending on market conditions.

From a debt perspective, at the end of the third quarter we had 450 million dollars outstanding on our one-billion-dollar revolving credit facility. Our revolving credit facility provides flexibility without any required loan amortization. To efficiently use our cash, while maintaining liquidity, we plan to repay 100 million dollars of debt in our fourth quarter. Accordingly, we anticipate outstanding debt to be 350 million dollars entering our fiscal year 2022. Our revolving credit facility expires in January of 2023 and has no required principal repayments until maturity.

To briefly recap other balance sheet highlights, accounts receivable, net, was 208.0 million dollars, down by 5.5 million dollars since the end of March. DSOs were 70 days versus 73 days at the end of fiscal year 2020 and 77 days at the same time last year. The improvement in the DSO's in the third quarter of this year compared with the third quarter of the prior year is primarily attributable to the timing of orders within the quarter.

### **Slide #16: FY'21 Guidance**

Let's move to slide 16 for our guidance. I will focus my review on our non-GAAP guidance.

#### ***FY'21 Guidance***

We have updated our fiscal year 2021 guidance, which was originally issued on October 29<sup>th</sup>, 2020. With one quarter remaining in the fiscal year, we are narrowing the range of our expected revenue performance and increasing our earnings per share expectations.

We now expect revenue for fiscal year 2021 to be in the range of 825 million dollars to 840 million dollars. We expect non-GAAP earnings per share to improve over last fiscal year and be in a range of 1 dollar and 60 cents to 1 dollar and 67 cents.

I would also like to note a few other items related to our outlook for fiscal year 2021. We anticipate our gross margin to be approximately 76 percent. We expect the full-year tax rate to be approximately 21 percent. Additionally, we expect the diluted weighted average shares outstanding for the fiscal year to be approximately 74 million shares.

That concludes my formal review of our financial results.

I'll now turn the call over to the operator to start Q&A.