



NETSCOUT SYSTEMS, INC.
Second-Quarter Fiscal Year 2022 Financial Results Conference Call
Management's Prepared Remarks

November 4, 2021

Tony Piazza: Introduction

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's second-quarter fiscal year 2022 conference call for the period ended September 30, 2021.

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. 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 and 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, 2021

and the Company's subsequent Quarterly Reports on Form 10-Q, all 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 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 and in today's earnings press release. They are also 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, everyone, and thank you for joining us today. Let's

begin on slide number 6 with a brief recap of our non-GAAP results for the second quarter and the first six months of fiscal year 2022.

Slide #6: Q2 & First Half FY'22 Financial Results

- We are pleased with our second quarter results, which have contributed to a solid foundation as we move into the second half of the fiscal year.
- Strong “software-only” product revenue growth in the second quarter supported our overall revenue increase, enhanced our margins, and improved our diluted earnings per share, on a year-over-year basis.
- Revenue increased more than 3 percent in the second quarter to 211.9 million dollars, driven by product revenue growth of more than 10 percent, which was partially offset by a decline of less than 3 percent in service revenue attributable to service provider consolidation and legacy product line atrophy, compared with the same period last fiscal year.
- Diluted earnings per share increased approximately 24 percent to 47 cents, compared with the same quarter last year.
- On a year-to-date basis, for the first six months of fiscal year 2022, revenue increased more than 3 percent to 402.2 million dollars, driven by product revenue growth of more than 12 percent, which was partially offset by a decline of 3 percent in service revenue for the same reasons previously mentioned for the quarter. Diluted earnings per share increased approximately 22 percent to 67 cents for the first half of the fiscal year. All these comparisons relate to the same periods in the prior fiscal year.

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

Slide #7: Market Trends and Business Insights

As “Guardians of the Connected World,” our solutions continue to be vital. We provide borderless visibility and cybersecurity solutions that assure and secure the performance, availability, and security of our customers’ digital ecosystems. Our customers can leverage these solutions to compete more efficiently and effectively in the new economy, which is increasingly essential given the most-recent challenges brought about by the COVID-19 pandemic. Looking ahead, long-term technology trends, including 5G, digital transformation through cloud migration, and the requirement for greater cybersecurity protection, are all setting the stage for NETSCOUT’s continued advancement.

Elaborating on the cybersecurity area, we recently released our Threat Intelligence Report for the first half of 2021. In the report, we noted that the global cybersecurity crisis has continued to accelerate. Attack frequencies are up and on track for another record-setting year. The impact on both public and private organizations is tremendous. And these groups continue to seek solutions that can assist them with these enormous challenges while keeping their organizations safe.

Equipped with our Omnis Cyber solutions, we are well-positioned to continue supporting customers in this area. Our Omnis Cyber solutions combine our leading service assurance monitoring, troubleshooting, and forensic capabilities, with our cybersecurity intelligence, detection, and mitigation solutions. We are already starting to see interest on this front and Michael will discuss some advances in this area later on in his remarks. As we expect our new cybersecurity solutions to play a larger role in our growth next fiscal year, we are also analyzing

key metrics for this area of our business and plan to start reporting on them in our fiscal year 2023.

Now, I'd like to turn to our customer verticals to provide more perspective on our performance and the previously mentioned technology trends. During the quarter, as our customers dealt with the challenging supply chain environment and experienced procurement issues, our 'software-only' solutions enabled them to utilize their budgets more effectively by accelerating the timing of their purchases with us. This moved some deals that we had previously expected in the second half up earlier in the fiscal year. Conversely, the rise in "software-only" deals also helped to mitigate potential constraints on our operations from supply chain difficulties as well.

Enterprise Customer Vertical

In our enterprise customer vertical, revenue grew more than 7 percent in the first half of fiscal year 2022, compared to the same period last fiscal year. Organizations are beginning to spend again as they emerge from the pandemic and restart previously delayed projects. We expect this spending momentum to continue and anticipate mid-to-high single-digit revenue growth in our enterprise customer vertical for the full fiscal year based on our current deal pipeline. Michael will highlight some of the customer wins we achieved during the quarter in this vertical in his remarks.

Our newer enterprise products related to Smart Edge Monitoring for "remote work environments" as well as our Omnis Cyber Intelligence solutions, which address the

cybersecurity landscape, have been gaining customer interest. We expect a greater contribution to our results from sales of these products in our next fiscal year as customers' offices start to reopen. Such conditions will allow us to build our pipeline as our sales team resumes traveling, conducts more in-person customer meetings, and completes more proof of concepts demonstrating the value of our solutions in saving time, cutting costs, and reducing the mean-time-to-resolution.

Service Provider Customer Vertical

Moving to our service provider customer vertical. For the first half of the fiscal year, revenue was down just under 1 percent, compared to the same period in the prior fiscal year.

Looking ahead, we expect 5G deployments to continue and we are also advancing the radio frequency propagation modeling project orders we previously received, which will assist customers in planning their networks. However, we also note the cautious spending environment in the service provider customer vertical as well as provider consolidation and the atrophy of legacy product lines, which has resulted in lower service revenue. As such, based on our current deal pipeline, we anticipate that this vertical could experience a flat to mid-single digit revenue decline for the full fiscal year.

I would also like to point out that we received a second large 5G-related order from a Tier-1 domestic service provider during our second quarter. Michael will comment more on this service provider win during his remarks.

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

Slide #8: Outlook & Summary

With the first half of fiscal year 2022 behind us, we have a solid foundation to build on and are excited to continue working toward meeting our financial and operational objectives for the fiscal year. We continue to advance our “NETSCOUT without Borders” initiative. This initiative is focused on expanding our business with current customers by leveraging our incumbency to access both existing and new budgets, acquiring new customers through new consumption choices, and expanding our reach into high-value adjacencies that can leverage our “Smart Data,” such as expanded cybersecurity and big data analytics. As the world continues to emerge from the pandemic, we remain focused on meeting customers’ needs for service assurance and cybersecurity solutions that solve some of the connected world’s toughest challenges.

Based on our results to-date and our current deal pipeline, we are reiterating our outlook for low single-digit revenue and diluted earnings per share growth in the full fiscal year 2022. Jean will provide a recap on the numbers in her remarks.

I look forward to sharing our progress with everyone going forward as the fiscal year continues to unfold.

I'll now turn the call over to Michael for additional updates.

Slide #10: COO Update

Michael Szabados:

Thank you, Anil, and good morning, everyone. Slide 10 outlines the areas I will cover on today's call.

Customer Wins:

On the enterprise customer vertical front, we are seeing increased interest in our service assurance and cybersecurity solutions as organizations emerge from the pandemic and refocus on their important projects. In terms of service assurance projects, some of the drivers are data center transformation and business-critical application assurance projects. Meanwhile, our new Omnis solutions are attracting greater interest on the cybersecurity front.

From a service assurance solution perspective in our enterprise customer vertical, during the second quarter, we won a low eight-figure service assurance deal with a major domestic provider of human capital management services. The company depends heavily on its core business applications to fulfill its business obligations and found that its previous approach to solving issues was overly reactive and labor-intensive, making it ineffective and costly. Using our nGenius technology, we demonstrated expedited issue resolution, which allowed the customer to identify and resolve, in less than half an hour, problems that had historically required large "war room meetings" and many man-hours, or even days, for resolution. The needs fulfilled by our solutions in this example are not isolated to this company. Today, while the largest organizations still struggle with exploding complexity, for which their existing tools are challenged to resolve, our solutions remain well-suited to reduce their mean-time-to-resolutions.

On the cybersecurity side in our enterprise customer vertical, our Omnis security solutions are beginning to gain traction. During the quarter, we won a high-six-figure deal with a domestic educational institution that purchased both our Omnis security solutions as well as our Visibility-as-a-Service (VaaS) offering. We won the deal against the incumbent due to the superiority of our security database as well as our patented and differentiated ASI technology, which has gained prominence in the industry over the past few years.

In the service provider customer vertical, we continue to see momentum around 5G globally. Some customers are continuing their planning with radio frequency propagation modeling projects, while others are advancing their deployments.

As Anil mentioned, during the second quarter, we won an eight-figure deal with a leading Tier-1 domestic service provider. This is the second 5G-related order that we have received from this provider as they accelerate their 5G build-out and offerings to compete for domestic industry leadership. Our market-leading solutions, combined with our responsive customer service, solid relationship, and strong incumbency, continue to win us business from this provider as they advance their offerings.

Go-to-Market Activities:

On the Go-to-Market front, we continue to launch our new offerings and advance our partnerships and collaborations.

From the perspective of offerings, we recently announced the launch of the Omnis Cyber

Intelligence solution. By leveraging NETSCOUT's market-leading service assurance technology, the Omnis Cyber Intelligence solution can provide insight into normal and anomalous network behavior to help mitigate network security risks earlier in the attack life cycle and stop future attacks. We also announced the launch of our Visibility-as-a-Service, or "VaaS" offering, which provides turnkey protection for customers' business-critical applications and digital services on a subscription basis. This service allows companies to leverage the deep expertise of the NETSCOUT VaaS engineering team to help monitor and troubleshoot issues quickly as well as help alleviate the resource shortages faced by IT organizations worldwide.

In terms of partnerships and collaborations, we recently announced a partnership with Palo Alto Networks involving the integration of our DDoS products with their security and orchestration products. This integrated solution will help enterprises reduce risk and increase service availability by enabling security operations centers to detect, analyze, and mitigate security threats in complex hybrid environments. From a collaboration perspective, later this year, we'll be exhibiting at AWS's Re:Invent show in Las Vegas, to demo our collaboration with AWS in cloud migration and security areas.

That concludes my prepared remarks. I will now turn the call over to Jean.

Slide #11: CFO Review

Jean Bua:

Thank you, Michael, and good morning, everyone. I will now review our key second quarter and first-half fiscal year 2022 metrics. 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 First-Half FY'21 Results

Slide number 12 details our results for our second quarter and first-half of fiscal year 2022. Focusing on the quarterly performance, revenue grew 3.2 percent from the same quarter in the prior year to 211.9 million dollars. Product revenue grew 10.5 percent year-over-year, primarily due to higher “software-only” product sales. “Software-only” product revenue was 45 percent of service assurance product revenue, compared with 27 percent in the same period of the prior fiscal year. Service revenue declined 2.7 percent over the prior year’s quarter. As we stated on our last earnings call, the decline in service revenue is primarily attributable to non-renewals associated with service provider consolidation and legacy product lines.

Our second-quarter fiscal year 2022 gross profit margin was 78.3 percent, up 3.6 percentage points over the same quarter last year. The increase is primarily due to the higher contribution from “software-only” revenue, which has a higher gross margin, and lower contribution from radio frequency propagation modeling project revenue, which has a lower gross margin, compared to the same period in the prior year. Quarterly operating expenses increased 4.4 percent from the prior year, largely due to higher sales incentive compensation attributable to higher revenue, increased marketing program spending, and a one-time accrual reversal attributable to legal-related expenses and penalties that occurred in the prior year’s quarter. We reported an operating profit margin of 22.3 percent compared with 19.4 percent in the same quarter last year. Diluted earnings per share increased by 23.7 percent to 47 cents, from 38 cents in the same quarter of the last fiscal year.

Slide #13: 1 H FY'22 Revenue Trends: Customer Verticals

Turning to slide 13, I'd like to review key revenue trends for the first half of the year. For the first six months of fiscal year 2022, the enterprise customer vertical revenue grew approximately 7.5 percent, while the service provider customer vertical revenue declined approximately 0.9 percent.

For the first six months of the fiscal year, approximately 52 percent of total revenue was generated from the enterprise customer vertical with the remaining approximately 48 percent of total revenue generated from the service provider customer vertical.

Slide #14: 1 H FY'22 Revenue Trends: Geographic Mix

Turning to slide 14, which shows our geographic revenue mix on a GAAP basis. Revenue by geography continues to be domestically weighted, despite international revenue increasing compared with the same period in the prior year. There was one customer that represented 10% or more of revenue in the quarter, but no such customer 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 cash, cash equivalents, short-term marketable securities, and long-term marketable securities of 475.8 million dollars, representing a decrease of 18.1 million dollars since the end of the first quarter. Free cash flow generated in the quarter was 21.6 million dollars. We repurchased 24.6 million dollars, or 921,299 shares of our common stock during the quarter, at a weighted average price of 26 dollars and 75 cents (\$26.75) per share. We currently have capacity

in our share repurchase authorization and, subject to market conditions, plan to be active in the market during our third quarter. From a debt perspective, as of the end of the second quarter, we had 350 million dollars outstanding on our 800-million-dollar revolving credit facility that matures in July of 2026.

To briefly recap other balance sheet highlights, accounts receivable, net, was 162.9 million dollars, down by 34.8 million dollars from the end of March. DSOs were 64 days versus 75 days at the end of fiscal year 2021 and 65 days at the same time last year.

Slide #16: FY'22 Outlook

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

FY'22 Outlook

As Anil noted in his earlier comments, we are reiterating our non-GAAP outlook issued during our first quarter earnings call on July 29, 2021. For fiscal year 2022, the expected revenue range is 835 to 865 million dollars, which implies low single-digit growth and reflects the slight pressure on service revenue that we continue to experience due to service provider consolidation and legacy product lines. The anticipated effective tax rate is expected to be between 21 and 23 percent. Assuming approximately 75 million weighted average diluted shares outstanding, the non-GAAP diluted earnings per share range is expected to be between 1 dollar and 71 cents (\$1.71) and 1 dollar and 77 cents (\$1.77).

I'd also like to offer some "color" on our non-GAAP outlook for the third quarter of the fiscal year. As we assess the opportunities in front of us, we anticipate that third quarter revenue will grow in the low-single-digits on a year-over-year over basis. We also anticipate that the product mix for the third quarter will consist of higher radio frequency propagation modeling revenue, and due to the labor-intensive nature and higher cost of this type of revenue, we expect a lower gross margin in the third quarter than that of the same period in the prior fiscal year. Accordingly, we anticipate that our diluted earnings per share in the third quarter will be lower by mid-single digits, compared with the prior year's third fiscal quarter.

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