

Keysight Technologies Second Quarter 2021 Earnings Conference Call

Prepared Remarks

JASON KARY

Thank you, and welcome everyone to Keysight's Second Quarter Earnings Conference Call for Fiscal Year 2021.

Joining me are Ron Nersesian, Keysight's Chairman, President and CEO, and Neil Dougherty, our CFO. Joining us in the Q&A session will be Satish Dhanasekaran, Chief Operating Officer, and Mark Wallace, Senior Vice President of Global Sales.

You can find the press release and information to supplement today's discussion on our website at investor.keysight.com. While there, please click on the link for quarterly reports under the financial information tab. There you will find an investor presentation along with Keysight's segment results. Following this conference call, we will post a copy of the prepared remarks to the website.

Today's comments by Ron and Neil will refer to non-GAAP financial measures. We will also make references to "core" growth, which excludes the impact of currency movements and acquisitions or divestitures completed within the last twelve months. You will find the most directly comparable GAAP financial metrics and reconciliations on our website. All comparisons are on a year-over-year basis unless specifically noted otherwise.

We will make forward-looking statements about the financial performance of the company on today's call. These statements are subject to risks and uncertainties and are only valid as of today. The company assumes no obligation to update them. Please review the company's recent SEC filings for a more complete picture of our risks and other factors.

Lastly, I would highlight that management is scheduled to participate in upcoming virtual investor conferences hosted by J.P. Morgan, Stifel, Baird, UBS, and Bank of America.

And now I will turn the call over to Ron.

RON NERSESIAN

Thank you, Jason, and thank you everyone for joining us.

Keysight delivered a record quarter and we are entering the second half of the year with momentum. Our broad portfolio of differentiated solutions continues to drive growth across a diverse set of growing markets.

Today, I'll focus my comments on three key headlines.

- First, we delivered outstanding Q2 results with all-time record orders, revenue and free cash flow.
- Second, Keysight is enabling leading-edge disruptive innovation around the world. Our solutions have significant differentiation, and contribute significant value to customers which is fueling our growth for the long term.
- Third, while we are managing longer lead times and component availability, our leading market position, strong customer relationships, and supply chain resiliency give us confidence in our ability to deliver on our commitments.

Now, let's take a deeper look across our second quarter performance across both business segments. Record orders of \$1.3 billion grew 22 percent. Revenue grew 36 percent to \$1.2 billion, which was an all-time high. We delivered second quarter gross margin of 64 percent, operating margin of 26 percent, and earnings of 1 dollar 44 cents, which was above the high end of our guidance and represents 85 percent year-over-year earnings growth. We also achieved record free cash flow of \$369 million. Over the last 12 months Keysight generated just over \$1 billion of free cash flow that we've deployed through approximately \$500 million in acquisitions and \$455 million in share repurchases. We continue to be active and disciplined in our capital deployment.

Second quarter strength was broad-based, with double-digit order and revenue growth across all markets and regions. Outstanding results by both business segments demonstrate the power of Keysight's diversified portfolio in 5G and beyond.

Our Electronic Industrial Solutions Group achieved its third consecutive quarter of record revenue, with strong double-digit order and revenue growth in general electronics, semiconductor and automotive.

The breadth of our contributions across multiple industries is exemplified by our double-digit order and revenue growth in our general electronics business. With ongoing investment in broad digital transformation, including advanced consumer electronics, digital healthcare, and

industrial IoT, Keysight is enabling innovation and capturing technology inflections for the IoT ecosystem.

Strong demand for our semiconductor solutions drove record orders and revenue. Customer investment in advanced technology nodes remains high, while capacity is expanding for mature processes to address surging global semiconductor demand.

In automotive, record orders resulted from improved macro conditions and increasing investments in EV and AV technologies. Keysight's solutions portfolio for the automotive market continues to expand with new advanced technologies such as AC power emulation, millimeter wave radar, power semiconductor technology, automotive ethernet, C-V2X, and cyber security software systems. As the reinvention of automotive ecosystems continues, Keysight is enabling the disruptive innovation of new mobility technologies.

Our Communications Solutions Group achieved record orders and delivered double-digit order and revenue growth in commercial communications and aerospace, defense and government.

Aerospace, defense and government revenue grew 46 percent, driven by strong demand in space, satellite, signal monitoring, 5G and early 6G research applications. Keysight's engagement with key industry players remains strong. We've recently enabled a large prime contractor's first test bed, and have secured multiple 5G solution wins in the aerospace, defense and government market.

Commercial communications orders and revenue both grew double digits, driven by ongoing investments in 5G and 400G/800G ethernet solutions for data centers. As 5G progresses and deployments drive sustained investment, we are uniquely positioned to capture the opportunities ahead as the ecosystem scales. Recent engagements include a broadening set of new customers, as well as key industry players such as NEC, Fujitsu, and MediaTek. We continue to maximize the 5G lifecycle opportunity and lead the industry with differentiated 5G solutions. In addition, the success of our application layer strategy is reflected in the strong demand for new technologies, such as ORAN, and business expansion in new end-to-end verticals. Our ability to provide complete solutions for network protocol test, security and visibility is enabling us to solve many challenges across the industry.

In another area of disruption, we continue to advance our long-term initiative to enable the Quantum revolution. We are growing our Quantum engagements with key customers worldwide. We also expanded our Quantum solutions portfolio this quarter with the

acquisition of Quantum Benchmark, which brings deep expertise in the performance validation software for quantum computing.

Keysight's software-centric solutions and higher value services continue to drive differentiation and recurring revenue growth. For the second quarter in a row, software and services each delivered double-digit order and revenue growth.

Beyond innovation, execution and financial discipline, Keysight's culture has long embraced corporate social responsibility. We believe our focus on climate and diversity provides us with a competitive advantage. We recently published our annual CSR report, which includes progress toward our prior goals and the announcement of our commitment to achieving net zero emissions in the company operations by 2040. We are working to set interim science-based targets to ensure our progress towards this goal. Diversity and inclusion are also embodied in our Keysight Leadership Model. As a CEO priority, we have specific goals and actions that will be tracked by our leadership team and the Board of Directors. A Keysight Diversity & Inclusion brief will be published this month that describes our long-standing D&I philosophy, as well as the details of our strategies and goals. While there is more work to do, Keysight remains steadfast in our commitment to CSR and building a better planet.

As we look ahead, we are encouraged by the strong demand for our differentiated solutions, while managing longer lead times and component availability constraints. Our in-house high-performance semiconductor fab and the strength of our order fulfillment team are helping us manage these near-term supply chain challenges, and give us confidence in our ability to navigate them entering the second half of this year.

In summary, Keysight is enabling disruptive innovation across multiple waves of technology, with a decades-long runway ahead of us. Our execution in the face of many dynamic challenges this past year is a testament to the Keysight Leadership Model, our employees, and the breadth and depth of our customers.

Now, I would like to turn it over to Neil to discuss our financial performance and outlook in more detail.

NEIL DOUGHERTY

Thank you, Ron, and hello, everyone.

As Ron mentioned, the Keysight team delivered another outstanding quarter and better-than-expected results, as robust demand for our differentiated solutions and continued macro recovery resulted in strong growth across all regions.

Second quarter revenue of \$1 billion 221 million was above the high end of our guidance range, and grew 36 percent, or 33 percent on a core basis, versus a soft compare due to COVID-related disruption. Q2 revenue growth was driven by broad strength across all markets and geographies, as the Keysight team navigated macro dynamics and supply chain constraints.

We achieved second quarter orders of \$1 billion 332 million, up 22 percent, or 19 percent on a core basis.

Turning to our operational results for Q2, we reported gross margin of 64 percent, which increased 170 basis points. Operating expenses of \$467 million were well-managed, resulting in operating margin of 26 percent. As discussed last quarter, variable pay expense increased approximately \$30 million sequentially as a result of higher revenue growth and operating margin.

We achieved net income of \$270 million, and delivered 1 dollar 44 cents in earnings per share, which was above the high end of our guidance. Our weighted average share count for the quarter was 187 million shares.

Moving to the performance of our segments, our Communications Solutions Group achieved second quarter revenue of \$877 million, up 34 percent, while delivering gross margin of 65 percent and operating margin of 25 percent.

Commercial communications orders and revenue in the second quarter were all-time highs. Revenue of \$606 million increased 30 percent driven by continued investments across the 5G lifecycle.

Aerospace, defense and government revenue of \$271 million grew 46 percent, resulting from strong demand across all regions, primarily in the US and Asia Pacific, followed by a strong recovery in Europe.

The Electronic Industrial Solutions Group generated record revenue of \$344 million, up 42 percent, or 37 percent on a core basis. Order and revenue strength was notable across all

regions, particularly in Asia Pacific. Semiconductor, general electronics measurement, and automotive solutions orders and revenue all grew strong double-digit. EISG reported gross margin of 64 percent and operating margin of 28 percent.

Moving to the balance sheet and cash flow, we ended our second quarter with approximately \$2 billion in cash and cash equivalents and reported cash flow from operations of \$402 million and free cash flow of \$369 million, or 30 percent of revenue. Our capital allocation priorities are unchanged and are focused on investments in organic growth, value-creating acquisitions, and share repurchases.

Under our share repurchase authorization, during the quarter we acquired 1.59 million shares on the open market, at an average price of \$138.36, for a total consideration of \$220 million.

Now, turning to our outlook and guidance ...

We expect third quarter 2021 revenue to be in the range of \$1 billion 205 million to \$1 billion 225 million, which represents 20 percent revenue growth at the midpoint. We expect Q3 earnings per share to be in the range of 1 dollar 39 cents to 1 dollar 45 cents, based on a weighted diluted share count of approximately 187 million shares.

In closing, we are entering the second half of the year with strong momentum. We are pleased with our operational execution and remain confident in our ability to drive growth and deliver on our commitments.

With that, I will now turn it back to Jason for the Q&A.

JASON KARY:

Thank you, Neil. Operator, will you please give the instructions for the Q&A?