



Keysight Technologies Fourth Quarter 2022 Earnings Conference Call
Prepared Remarks

JASON KARY

Thank you, and welcome everyone to Keysight's Fourth Quarter Earnings Conference Call for Fiscal Year 2022.

Joining me are Keysight's President and CEO Satish Dhanasekaran, and our CFO, Neil Dougherty. In the Q&A session we will be joined by Senior Vice President of Global Sales and Chief Customer Officer, Mark Wallace.

You can find the press release and information to supplement today's discussion on our website at investor.keysight.com under the financial information tab and quarterly reports.

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

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. We assume no obligation to update them. Please review our recent SEC filings for a more complete picture of these risks and other factors.

Lastly, management is scheduled to participate in upcoming investor conferences hosted by Credit Suisse and Wells Fargo. We hope to see many of you there.

And now I will turn the call over to Satish.

SATISH DHANASEKARAN

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

Keysight reported strong fourth quarter results which exceeded the high end of our guidance and drove a strong finish to the year. Before we get into the quarter, I want to highlight our exceptional performance for the full fiscal year, which illustrates continued progress we are making in transforming the company to a software-centric solutions provider. We set new records for orders, which grew 12 percent to \$6 billion; a new record for revenue, which was up 10 percent; and a new record for earnings per share, which increased 22 percent, all while returning capital through \$849 million in share repurchases, or 89 percent of free cash flow. In addition, we continued to invest in next-generation technologies for long-term differentiation and see a high level of engagement and activity with our customers around their future needs.

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

- First, we delivered all-time record revenue and earnings per share in the fourth quarter, ahead of expectations, enabled by outstanding execution by Keysight teams, who successfully navigated supply chain, geopolitical, and macro dynamics.
- Second, we achieved record orders of \$1.6 billion with steady bookings throughout the quarter and a book-to-bill of 1.09. While our customers' multi-year roadmaps remain unchanged, they are exercising more caution given the macro backdrop, which we anticipate will moderate demand in the near term.
- Third, as we enter FY23, we remain confident in our ability to outperform the market based on the differentiation of our solutions, our strong R&D customer value proposition, and the robust backlog position we have entering the year. And as we look longer term, the secular innovation trends in our end markets remain strong.

Now let's take a deeper look at the strength of our fourth quarter.

Record orders of \$1.6 billion grew 9 percent on a core basis. Record revenue grew 15 percent on a core basis, with solid growth across all regions, as Keysight teams successfully navigated challenging dynamics. This resulted in record quarterly earnings of 2 dollars 14 cents per share.

The strength and resiliency of our business model is due to our strategic efforts to diversify our industry exposure. This has been best exemplified in the growth of our Electronic Industrial Solutions Group, and our ability to leverage our industry leading, first-to-market solutions to enable expansion across the broader communications ecosystem.

EISG achieved its ninth consecutive quarter of double-digit order and revenue growth. Auto, semiconductor solutions, and general electronics all achieved record quarterly revenue. For the year, both orders and revenue set new records, as we capitalized on continued investments across all three EISG markets.

In automotive, we are pleased with the continued adoption of our solutions portfolio as orders grew double digits for the seventh consecutive quarter and exceeded \$500 million this year. Automotive OEMs and their suppliers continued to focus on strategic new mobility investments which drove key wins for Keysight. In addition, automotive-focused semiconductor companies continued to add capabilities to support EV and AV applications, which we view as a favorable long-term dynamic. We recently announced the ScienLab DC Emulator, which enables customers to accurately characterize high-voltage, high-power electric vehicle battery performance under varying real world charging conditions. And Keysight's PathWave Lab Operations software won the 2022 AutoTech Breakthrough Award for Overall Electric Vehicle Technology.

In support of AV applications, silicon designers are exploring adoption of commercial standards, such as MIPI, for automotive and other surround-sensor applications, including cameras and in-vehicle infotainment displays. We are now expanding our leading compliance test solutions to offer advanced verification and diagnostic capabilities for automotive designers.

Turning to our semiconductor solutions business, Q4 was the tenth consecutive quarter of double-digit order growth and a record revenue quarter. We saw sustained demand for our wafer test solutions and precision positioning capabilities, which enable the realization of advanced process nodes. In addition, Keysight has continued to partner with industry leaders Synopsys and Ansys on RF and millimeter wave integrated circuit design flows built for today's wireless communications requirements, including 5G and 6G systems-on-chip. Keysight received a Partner of the Year Award from TSMC for joint development design flows in RF and mm wave nodes.

In general electronics, record orders grew double digits this quarter as demand remained strong and broad-based across industrial IoT and digital health as well as education and advanced research markets.

Turning to our Communications Solutions Group, the business delivered strong orders and record revenue. Annual orders and revenue were all-time highs, despite geopolitical headwinds and delays in U.S. defense budget appropriations.

Commercial Communications revenue grew 10 percent this quarter and 11 percent for the year, with growth across all regions. Investment across the communications ecosystem continued throughout the year, with sustained spending in next-generation wireless and wireline technologies. Ongoing investment in 5G standards, new spectrum, growing deployments around the world, and the steady evolution from 400G to 800G to terabit Ethernet drove growth. We had another record year for 5G orders as Keysight's market leading solutions continue to provide the industry with new capabilities needed for the development of next-generation devices, as well as wireless and wireline networks.

Examples that highlight our portfolio's alignment with key industry priorities include a recent partnership with IBM to integrate our ORAN capabilities into their cloud automation tools to accelerate network deployments. We also completed the validation of the first 5G location-based service use case from the Global Certification Forum, combining testing of 5G new radio and global navigation satellite system technologies into a single platform. Lastly, in



collaboration with key silicon and data center partners, we enabled the industry's first 1.6 Terabit transmission and data center interconnect leveraging our high-speed digital solutions.

Aerospace, defense and government business revenue grew 4 percent for the quarter and 3 percent for the year, setting a new record while navigating geopolitical headwinds. Steady investments in spectrum operations, cybersecurity, and space and satellite drove demand. 5G continued to expand in the aerospace and defense end market and we saw increasing investment in advanced research. Proposed increases in investment in the US and allied countries for the modernization of defense capabilities and new space and satellite applications position us well for future opportunities.

As an integral part of our solutions strategy, software and services order and revenue growth this year continued to outpace Keysight overall, which has driven our annual recurring revenue to approximately \$1.2 billion. Software and services again represented just over one-third of Keysight's total revenue for the year.

Keysight's focus on customer success and innovation is driving our development of first-to-market, high-value solutions. Our achievements over the years exemplify Keysight's collaborative culture and our talented workforce, and we're honored that Keysight has placed 10th on the Fortune Best Workplaces in Technology™ list for 2022. We believe our differentiated culture gives us a unique ability to recruit and develop capable talent and will be our sustaining competitive advantage.

In conclusion, I would like to thank our employees for all their contributions, commitment, and strong track record of execution. In the midst of an uncertain economic environment, we remain confident in the resilience of our business, the strength of our balance sheet, and the flexibility of our operating model.

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

NEIL DOUGHERTY

Thank you, Satish, and hello, everyone.

We delivered an outstanding fourth quarter of 2022, with record revenue of \$1 billion 443 million, which was above the high end of our guidance range, and grew 11 percent, or 15 percent on a core basis.

Our strategies to navigate the on-going supply constraints continued to be effective. While the supply chain situation improved within the quarter, it continues to moderate our near-term revenue expectations.

Record orders of \$1 billion 570 million increased 5 percent, or 9 percent on a core basis, and we entered fiscal year 2023 with over \$2.5 billion in backlog.

Looking at our operational results for Q4, we reported gross margin of 64 percent, which, as expected, was down 80 basis points sequentially due to inflationary pressures and increased shipments of lower-end instruments enabled by the improving supply chain. Operating expenses of \$495 million were well-managed and we generated operating margin of 30 percent.

Net income was a record \$386 million, and we achieved 2 dollars 14 cents in earnings per share, which was 14 cents above the high-end of our guidance. Our weighted average share count for the quarter was 180 million shares. Foreign exchange impact on our earnings was negligible thanks to a meaningful natural hedge provided by our global footprint, which was then supplemented by our financial hedging program.

Moving to the performance of our segments, the Communications Solutions Group achieved record revenue of \$992 million, up 8 percent, or 11 percent on a core basis. CSG delivered gross margin of 66 percent and operating margin of 29 percent.

Commercial Communications generated revenue of \$681 million in the fourth quarter, up 10 percent, driven by strength across the 5G ecosystem, increasing O-RAN adoption, and investment in 800G and 1.6 Terabit R&D.

Aerospace, Defense and Government achieved record revenue of \$311 million, up 4 percent, driven by double-digit growth in Asia Pacific and Europe.

The Electronic Industrial Solutions Group achieved record revenue of \$451 million, up 20 percent, or 25 percent on a core basis, driven by strength across all markets. EISG reported gross margin of 60 percent, and operating margin of 32 percent.

Turning to our full-year financial performance, Keysight delivered outstanding results in 2022, despite on-going supply constraints, foreign exchange headwinds, and incremental trade restrictions. FY22 revenue totaled \$5.4 billion, up 10 percent year-over-year, or 12 percent on a core basis. Gross margin was flat at 65 percent, holding steady in the face of significant inflation. We invested \$813 million in R&D, while operating margin improved 140 basis points to 29 percent. FY22 non-GAAP net income was \$1.4 billion, or 7 dollars 63 cents per share, up 22 percent.

Moving to the balance sheet and cash flow, we ended our fourth quarter with more than \$2 billion in cash and cash equivalents, generating cash flow from operations of \$398 million and free cash flow of \$340 million. Total free cash flow for the year was \$959 million, representing 18 percent of revenue and 69 percent of non-GAAP net income.

Share repurchases this quarter totaled approximately 800 thousand shares at an average price per share of \$158.77, for a total consideration of \$126 million. This brings our total share repurchases for the year to approximately 5.4 million shares, at an average share price of \$156.09, for a total consideration of \$849 million, or 89 percent of free cash flow.

Now, turning to our outlook and guidance ... we exit the year with record backlog, and confidence in Keysight's ability to continue executing through near-term uncertainties. As a

result, we expect first quarter 2023 revenue to be in the range of \$1 billion 360 million to \$1 billion 380 million, and Q1 earnings per share to be in the range of 1 dollar 81 cents to 1 dollar 87 cents, based on a weighted diluted share count of approximately 180 million shares.

A few modeling reminders as we enter the year... our annual compensation cycle is administered in Q1, and in this current inflationary environment, we expect our second consecutive year of wage increases above our historic average. We are targeting FY23 R&D investment at approximately 16 percent of revenue. Annual interest expense is expected to be approximately \$80 million, capital expenditures are expected to be approximately \$250 million, and we are modeling a 12 percent non-GAAP effective tax rate for FY23.

In closing, we recognize the uncertainty of the current macro environment, and will continue to be disciplined. Keysight's highly flexible cost structure, track record of execution, diverse end markets, and long-term secular growth drivers, give us confidence in our ability to outperform the market.

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