



## Keysight Technologies Second Quarter 2023 Earnings Conference Call

### Prepared Remarks

#### **JASON KARY**

Thank you, and welcome everyone to Keysight's Second Quarter Earnings Conference Call for Fiscal Year 2023.

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 Chief Customer Officer, Mark Wallace.

The press release and information to supplement today's discussion are on our website at [investor.keysight.com](http://investor.keysight.com) under the financial information tab and quarterly reports. Today's comments 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 JP Morgan, Baird, and UBS.

And now I will turn the call over to Satish.

**SATISH DHANASEKARAN**

Thank you Jason, good afternoon everyone, and thank you for joining us today.

Keysight delivered a solid second quarter performance, capping off a record first half of the year. Our consistent execution as we navigate near-term macro dynamics reflects the resilience of our diversified business and the differentiation of Keysight's solutions portfolio.

My comments today will focus on three key headlines.

- First, our strong financial performance in the second quarter demonstrated the depth and the breadth of Keysight's solutions and operating discipline. Revenue was at the high end of our guidance and earnings per share exceeded our guidance range, as we delivered record gross margin and record free cash flow.
- Second, orders in the second quarter were stable and consistent with our expectations. As near-term macro dynamics play out, we are capitalizing on growth opportunities across our end markets, with particular strength in automotive and global aerospace and defense.
- And third, we remain confident in the long-term secular growth trends in our markets. While the current environment is uncertain, we are continuing to prudently invest for the future - to build on our leadership positions - and to deliver on the long-term strategy that I laid out at our Investor Day in March.

Now let's take a deeper look at our second quarter results.

Orders declined 10 percent, or 8 percent on a core basis. Record Q2 revenue grew 3 percent, or 5 percent on a core basis. Operational excellence, combined with favorable software and services mix, resulted in record gross margins of 67 percent, operating margin of 30 percent, record free cash flow of \$370 million, and earnings per share growth of 16 percent.

Turning to our business segments...

The Electronic Industrial Solutions Group delivered record Q2 orders, driven by demand in automotive and general electronics. Representing 33 percent of the total company revenue, EISG revenue was an all-time high and grew 17 percent, with strong double-digit growth across all end markets. This was also the 11<sup>th</sup> consecutive quarter of double-digit revenue growth for this business segment, which underscores our broad market reach and diversified portfolio.

In automotive, we delivered strong double-digit revenue growth and secured new strategic wins with two large OEMs. Building on our strong position in this market, we introduced further automation and protocol test capabilities for our industry-leading EV charging test portfolio, allowing customers to accelerate their innovation. Improved battery performance and ease of charging are among the most critical capabilities EV developers are bringing to consumers today. Keysight's complete solutions allow

customers to develop batteries with better range and faster charging time, and importantly, to efficiently test their interoperability against all global infrastructure standards under real world conditions.

General electronics revenue grew by double-digits to reach an all-time high. We are capitalizing on opportunities across a broad range of applications. For example, in quantum and silicon photonics where we are seeing more advanced research investment; in digital health, where we closed deals with several prominent medical device customers for Keysight's microwave sensing and imaging solutions; and, in industrial automation, where customers are developing components and products to connect factory and warehouse environments.

Our outperformance in general electronics in a soft demand environment demonstrates the benefit of the broad and diverse set of applications and use cases that we enable.

Semiconductor solutions delivered double-digit revenue growth, driven by continued fab investments in new wafer capacity and advanced nodes. Our strong relationships with key customers in wafer test and precision lithography provide us with long range demand visibility, which remains favorable despite near-term inventory headwinds. We believe the long-term growth drivers remain intact, supported by the government investments in initiatives such as CHIPS Act, and advanced node development for smaller, more efficient, and multifunctional chipsets.

Turning to our Communications Solutions Group, revenue declined 3 percent against a strong compare of double-digit growth last year. At 45 percent of company revenue, commercial communications revenue declined 7 percent, which reflects the normalization of the demand environment that we referenced last quarter. We saw cautious but stable spending across the communications ecosystem, particularly in the smartphone and PC computing markets, as customers work through post-pandemic inventory dynamics and macro uncertainty. At the same time, our customers continue to invest in long-range, strategic R&D programs. Keysight's first-to-market solutions are enabling future requirements in 5G, including non-terrestrial networks, Release 17 capabilities, O-RAN, AI-ML driven data center networks, and early 6G research.

After a three-year pause, we saw strong global industry participation at Mobile World Congress and Optical Fiber Conference this year. At these events, we showcased our capabilities with key industry players to advance new technologies and use cases. This quarter we enabled Samsung to demonstrate 5G New Radio non-terrestrial network use cases in satellite connectivity. In addition, we secured a key win in commercial space to test antennas, transceivers, and telemetry systems. Keysight is also enabling ongoing O-RAN adoption. For example, CableLabs used Keysight Open RAN Architect solutions to achieve key interoperability milestones. Regionally, we saw strength in India with ongoing 5G and O-RAN deployments. Strategic data center R&D activity continues to gain momentum, and Keysight secured an early win with a leading customer to implement AI-ML use cases. Our unique and comprehensive solutions stack, which spans the physical, protocol, and application layers, is enabling us to capitalize on these new market and technology inflections.



We are also continuing to advance early 6G research with industry leaders around the world. In Japan, we engaged with NTT Docomo on new spectrum technologies for sub-terahertz frequencies. In the UK, in collaboration with the National Physical Laboratory and University of Surrey, we enabled connectivity at speeds greater than 100 gigabits per second using Keysight's 6G testbed.

Turning to our aerospace, defense, and government business, we achieved record second quarter orders and revenue. Double-digit order growth was driven by increasing defense spending worldwide. At 22 percent of company revenue, ADG revenue was up 7 percent. Defense modernization spending remained strong in radar and spectrum operations, while investment in space and satellite, and ongoing research in 5G and 6G, drove growth. We saw strong demand from the US and European primes with spend picking up in next-generation programs. We recently announced a software-based, real-time spectrum analysis solution, allowing satellite network operators to provide users with the highest quality of service. Keysight continues to innovate to meet the needs of this evolving market.

Software and services revenue growth across business segments was steady and represented over one-third of company revenue. Value-added solutions are becoming increasingly important in the rapidly evolving design, emulation, and test environments. In collaboration with Synopsys and Ansys, we recently announced a 79GHz millimeter wave radio frequency reference flow for TSMC. This allows us to provide mutual customers with the solutions they need to push the boundaries of RF and mmWave design into applications for autonomous systems. Technology megatrends and customers' innovation workflows are driving an expansion in software opportunities. We expect software and services growth to continue to outpace overall company growth over the next three years.

Before I turn it over to Neil, I'd like to highlight some of the things that make me proud to lead this company.

A collaborative and innovative culture is one of the strategic enablers of Keysight's continued value creation, and an enduring competitive advantage. We recently published our 2022 Corporate Social Responsibility report, which showcases the progress we have made against our commitments, and we're proud to have significantly surpassed many Key Impact goals for fiscal year 2022. We also released our 2022 Diversity, Equity, and Inclusion report, which highlights the company's accomplishments in building an inclusive workplace and expanding new STEM partnerships.

To sum it up, our market leadership and deep customer relationships are sustainable competitive advantages. We are guided by our Keysight Leadership Model, and run the company to outperform and to consistently create value under all business conditions. We believe the structural and financial flexibility of our operating model enables us to be resilient in the current macro environment. I would like to thank our employees for exemplifying a high-performance, winning culture, and consistently delivering exceptional value to our customers and shareholders.

With that, I'll now turn it over to Neil to discuss our financial performance and outlook.

**NEIL DOUGHERTY**

Thank you, Satish, and hello, everyone. We delivered exceptionally strong financial performance in Q2, demonstrating the resilience of our business model.

Revenue of \$1 billion 390 million was at the high end of our guidance range, and grew 3 percent, or 5 percent on a core basis.

Macroeconomic uncertainty continued to impact demand in the second quarter, and orders of \$1 billion 319 million declined 10 percent, or 8 percent on a core basis. We ended the quarter with over \$2.4 billion in backlog.

Turning to our operational results for Q2, we reported record gross margin of 67 percent and operating expenses of \$504 million, resulting in operating margin of 30 percent.

We achieved net income of \$380 million and delivered 2 dollars and 12 cents in earnings per share, which was above the high-end of our guidance. Our weighted average share count for the quarter was 179 million shares.

Moving to the performance of our segments, our Communications Solutions Group generated revenue of \$937 million, down 3 percent, or down 1 percent on a core basis. Commercial Communications revenue of \$627 million was down 7 percent. Aerospace, Defense and Government revenue of \$310 million increased 7 percent driven by investments in defense modernization. Altogether, CSG delivered record gross margin of 68 percent, and operating margin of 28 percent.

The Electronic Industrial Solutions Group generated second quarter revenue of \$453 million, up 17 percent, or 19 percent on a core basis, with double-digit revenue growth in automotive, general electronics, and semiconductor, demonstrating the diversity of our markets. EISG reported gross margin of 64 percent, and operating margin of 35 percent.

Moving to the balance sheet and cash flow, we ended our second quarter with \$2.5 billion in cash and cash equivalents, generating cash flow from operations of \$423 million, and free cash flow of \$370 million, or 27 percent of revenue, which includes \$107 million in one-time proceeds from the unwind of an interest rate swap.

Now, turning to our outlook...

In this challenging macro environment, the scenario we laid out last quarter for first-half demand levels to persist through the remainder of the fiscal year is playing out. However, given the strength of our operating model and the actions that we've taken to-date, we now anticipate better earnings performance than previously communicated, with strong mid-single digit EPS growth expected for the full year.



Turning to our third quarter guidance, we expect revenue to be in the range of \$1 billion 370 million to \$1 billion 390 million, and Q3 earnings per share to be in the range of 2 dollars to 2 dollar 6 cents, based on a weighted diluted share count of approximately 179 million shares.

Despite ongoing uncertainty, Keysight's durable and resilient financial model positions us well to outperform in the current economic environment. Over the longer term, we remain confident in the underlying demand drivers for our markets and our ability to execute and achieve our new, raised long-term targets as presented at our Investor Day in March.

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