Keysight Technologies Fourth-Quarter 2014 Results Conference Call Prepared Remarks

JASON KARY

Thank you, and welcome everyone to Keysight's Fourth Quarter Conference Call for Fiscal Year 2014. With me are Ron Nersesian, Keysight's President and CEO; and, Neil Dougherty, Senior Vice President and CFO.

Joining in the Q&A after Neil's comments will be Guy Séné, Senior Vice President of Measurement Solutions and Worldwide Sales, as well as Mike Gasparian, Senior Vice President of Customer Support and Services and Worldwide Marketing.

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 "Financial Information". There you will find an investor presentation with Keysight revenue break-outs and other relevant information. We will also post a copy of the prepared remarks following this call. In order to avoid selective disclosures, this call is simultaneously being webcast and a replay will be available for approximately 90 days.

Today's comments by Ron and Neil will refer to non-GAAP financial measures, which are consistent with how Agilent has reported Keysight as its electronic measurement segment in the past. You will find the most directly comparable GAAP financial metrics and reconciliations on our website.

We will make forward-looking statements about the financial performance of the company. 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, including the final amendment to our Form 10, which is Amendment number 8, for a more complete picture of our risks and other factors.

Lastly, note that between now and our next earnings call, Keysight will be participating in the investor conference hosted by Credit Suisse in early December.

And now, I'd like to turn the call over to Ron.

RON NERSESIAN

Thank you, Jason, and hello everyone. Welcome to the first Analyst Conference Call for Keysight Technologies as an independent company.

As a reminder, today we will discuss our Q4 and FY14 earnings results as reported by Agilent; however, we will provide guidance for Keysight Technologies as an independent company.

To start, I will share three headlines regarding Keysight's Q4 results.

- First, Q4 revenues of $762 million and non-GAAP operating margins of 21 percent were above the midpoint of our guidance.
- Second, our separation from Agilent and launch as an independent company have gone exceedingly well. We have identified no significant issues and stabilization is on track.
- Third, Keysight's strategic intent has not changed. We are focused on higher growth opportunities in electronic measurement, such as wireless communications, modular and software solutions.

Let's move to the specifics of our results.

Keysight revenues of $762 million increased 8 percent year-over-year. Orders grew for the third quarter in a row, with Q4 orders of $760 million, up 3 percent year-over-year. Keysight again delivered excellent profit margins that were above our guidance, generating operating profit of $160 million and an operating margin of 21 percent for the quarter.

Now let's take a look at our end markets.

Total Aerospace Defense revenues increased 10 percent year-over-year in Q4 with both the U.S. and Asia delivering strong performance.

In the U.S., Aerospace Defense spending from both direct government accounts and contractors continued to rise and seasonal demand was high in Q4 due to the government fiscal year-end. Looking internationally, Aerospace Defense in Asia was stronger year-over-year due to strength in Korea and India, and improved spending in China. In Europe, Aerospace Defense revenues were fairly flat.

Communications revenues grew 6 percent year-over-year in Q4. Wireless manufacturing growth was driven by strength in base station and component test.

Industrial, Computers, and Semiconductor revenue grew 9 percent year-over-year in Q4 with particular strength in Industrial end markets. FY14 was strong for Semiconductor markets, but bookings slowed in Q4.

Turning to regional performance, Keysight revenues grew year-over-year in the Americas, Europe and Japan, while the rest of Asia was slightly down. Americas grew 18 percent year-over-year with growth in all market segments and particular strength in Industrial and Communications. Europe grew 5 percent with strength in Communications offset by softness in other end markets.

Japan grew 7 percent year-over-year. Asia Pacific, excluding Japan, declined 1 percent as the growth trajectory of the past two quarters has flattened.

Turning to our products, this year we achieved record revenue for our oscilloscope product line. This is an example of our ability to drive growth when we focus our efforts over time.

As an independent company, Keysight continues to invest in the transformation of our product portfolio with a focus on modular, software, and certain wireless solutions. This will be a multi-year effort, and the progress we are making in these areas can be seen in our new product introductions.

In Q4, for wireless communications, we introduced the industry's first one-box tester dedicated to Femtocell manufacturing. Femtocells are small, low-powered cellular basestations that provide high data rate services in environments in which traditional large basestations cannot, such as dense urban areas and high mobility areas like a car on a freeway.

As part of our software strategy, we just released a 5G exploration library, which is the industry's first 5G

EDA solution. This software package gives our wireless communication customers a cost-effective way to start critical research even before the 5G standard is defined.

In modular, we introduced several new solutions this past quarter as we continue to accelerate our offering. For example, we introduced our first modular vector network analyzer with best-in-class performance regardless of “form factoring,” offering an important proof point for Keysight’s ability to take leading edge measurement technology from feature-rich box instruments and implement it into modular solutions.

We also introduced a modular logic analyzer that captures the industry’s highest data rates allowing engineers to measure the fast digital signals that are used in emerging technologies and to troubleshoot their designs with confidence.

That completes the summary of our quarter, and our last quarter as part of Agilent Technologies. We wish our past company success as they continue to thrive in their area of focus and contribution.

Keysight’s focus throughout the separation has been to make this significant transition as seamless as possible for customers. Our successful transition and fourth quarter results are due to the hard work of our employees, and I am very pleased with our achievements.

Keysight's success is driven by the perpetual evolution of electronic technology and our ability to enable customers to make breakthroughs in this complex and ever-changing environment.

We have a unique formula combining hardware, software and people to create measurement insight.

We have been technology leaders in hardware for 75 years. We have grown our annual software sales to over $300 million, and we have the world's leading electronic measurement experts to help our customers solve their most difficult technology problems.

Now, as an independent public company we are focused—from our front line employees to our executive staff—on creating long-term value for our shareholders and customers.

I will now turn it over to Neil to provide the details of Keysight's financial results as well as guidance for the next quarter.

NEIL DOUGHERTY

Thank you, Ron

Let me start by noting that the Keysight financials Ron and I are referencing are consistent with how Agilent has reported Keysight as its Electronic Measurement Segment in the past.

Specifically, these are non-GAAP segment results. We have provided GAAP financial statements for Keysight in our Form 10 through the end of Q3 FY14. Full-year GAAP financial statements for Keysight will be available in our 10K which we will file in December.

With this background, I'll recap Keysight's Q4 and FY14 results as reported by Agilent. In our fiscal fourth quarter, revenues of $762 million were up 8 percent, or 9 percent on a core basis. Keysight generated Q4 operating margin of 21.0 percent, an increase of 200 basis points year-over-year, while investing in R&D at a rate of 11.7 percent of revenue. The financial performance for the quarter was above the mid-point of our guidance range and demonstrated the strength and discipline of Keysight's operating model.

For the full year, Keysight generated revenues of $2.93 billion, representing 2 percent growth on both an absolute and core basis, with an operating margin of 19.1 percent. With only modest topline growth in FY14, Keysight generated $559 million in total operating profit, while investing 12.2 percent of revenue in research and development.

As Keysight moves into FY15 as a stand-alone company I want to highlight several areas that you should consider as you update your models for the business.

First, consistent with other companies in our industry, Keysight will begin to treat share-based compensation as a pro forma expense. This will better align our reported results with our industry peers. As a segment of Agilent, Keysight's FY13 and FY14 non-GAAP results included $38 million and $42 million of share-based compensation expense respectively.

Second, we have updated our separation-related dis-synergy projection from $11 million to $20 million as a result of $9 million in pension savings that did not materialize as expected. While we intend to offset these dis-synergies over time, you can assume the full amount is incremental in FY15.

Third, while it has no net economic impact, Keysight's real estate lease agreements with Agilent will cause approximately $15 million to shift out of operating income into other income. This shift will lower operating margin and consequently the operating margin incremental in FY15, but it has no net earnings impact.

Fourth, in October, Keysight issued $1.1 billion of debt. The annual interest expense associated with this indebtedness is expected to be $45 million.

Fifth, in support of Keysight's strategic focus on growth generation, we plan to increase our investment in R&D to 13 percent of revenue in FY15.

Sixth, in FY15 we expect our non-GAAP tax rate to be approximately 17 percent and our capital expenditures are estimated to be $100 million.

Lastly, we expect to have $5 million of incremental non-repeating expense in Q1 that does not qualify for pro forma treatment; however, we are reducing the pro forma separation-related expenses that we noted in our Form 10 by $5 million to $25 to 30 million over the next two years.

Now let's turn to our guidance for the first quarter of FY15.

Given the variable nature of our end markets, we believe it is important to align our guidance strategy with the visibility that our markets allow. As an independent company, we will provide revenue and operating margin guidance for the upcoming quarter.

We expect first quarter revenues in the range of $675 million to $715 million, which, at the midpoint, reflects growth of 3.6 percent, or 5.3% on a core basis with the difference due to currency. We expect first quarter operating margin to be between 14 and 17 percent.

You will recall that revenue, profit, and cash flow are seasonally lower in our first fiscal quarter. This can be seen if you review the published results for Agilent's Electronic Measurement Segment over the past several years. We expect a similar seasonal decline in Q1 FY15 as we see the impact of annual wage increases, variable pay, and other seasonally higher expenses.

While we will not be providing full-year guidance, I do want to reiterate our market expectations for FY15.

While we believe the long-term growth rate of our markets is 3 to 4 percent, we expect lower FY15 market growth in the range of 2.5 to 3.5 percent.

As an independent, public company, we are focused on growing in our markets while meeting our financial commitments. We intend to leverage our unique formula of hardware plus software plus people to create value for our customers and shareholders.

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