# Keysight Technologies First Quarter 2019 Earnings Conference Call

## Prepared Remarks

**JASON KARY**

Thank you, and welcome everyone to Keysight's First Quarter Earnings Conference Call for Fiscal Year 2019.

Joining me are Ron Nersesian, Keysight President and CEO; and Neil Dougherty, Keysight Senior Vice President and CFO. Joining us in the Q&A session will be Mark Wallace, Senior Vice President of Worldwide Sales, and Satish Dhanasekaran, President of the Communications Solutions Group.

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.

As a reminder and as we previously announced, we have changed our reporting segments due to an organizational change to align our services business with our customers and end markets. We are now reporting our operating results based on three segments: the Communications Solutions Group, the Electronic Industrial Solutions Group and the Ixia Solutions Group. Prior period results for these segments back to 2016 can also be found on our 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 as well as revenue from acquisitions or divestitures completed within the last twelve months. 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 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.

Note that management is scheduled to present at the Susquehanna Technology Conference in New York on March 12th. We hope to see many of you there.

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

**RON NERSESIAN**

Thank you, Jason, and thank you all for joining us. Keysight delivered an outstanding first quarter with both revenue and earnings exceeding the high-end of our guidance and very strong free cash flow. Our continued focus on strategic execution and commitment to operational excellence are delivering strong results for Keysight.

Today, I'll focus my formal comments on three key headlines for the quarter.

- First, it was a great start to the year and Keysight continued to deliver exceptional results. Revenue was well above our guidance and grew 18 percent, or 20 percent on a core basis, to surpass $1 billion dollars for the third consecutive quarter. We grew earnings high double-digits and delivered 93 cents in EPS, which also exceeded our guidance. And, we generated a record $209 million in free cash flow, an increase of 42 percent year-over-year.

- Second, customers continued to make strong R&D investments in next-generation technologies, and we continue to achieve broad-based momentum across multiple end markets with our solutions. Keysight is at the forefront of several emerging technology trends. With our broad and differentiated portfolio of solutions, software and services, we are capturing a significant portion of the demand we see in the marketplace.
- And third, looking forward, we believe we are well-positioned to continue to build on our success and expand our leadership. Given our strategic positioning in the key areas of the market, strong start to the year and outlook for Q2, we are confident in our revenue growth and earnings profile for the year.

Now let's take a deeper look into our performance for the first quarter. We achieved 93 cents per share in earnings, which was 14 cents above the midpoint and 11 cents above the high-end of our guidance. We delivered 81 percent earnings growth for the quarter versus a low compare in the previous year.

We also delivered record first quarter orders and strong order growth. Orders grew 5 percent in total and 7 percent on a core basis to exceed $1 billion. Revenue grew 18 percent, or 20 percent on a core basis, and was also above $1 billion, which is a record for first quarter revenue. This represents our third consecutive quarter of delivering over $1 billion in both orders and revenue.

Creating value for our customers by providing first-to-market solutions and insights that help them achieve innovation is the cornerstone of our strategy and Keysight Leadership Model. Our targeted investments in the key areas of the market undergoing multi-year transformations are delivering results. We are generating broad-based growth across multiple dimensions of the business, and software is increasingly becoming a larger part of our portfolio.

Revenue for our software solutions grew substantially higher than our overall growth rate in the first quarter to reach a new record. This growth was driven by demand for our 5G solutions, high-frequency measurement application software and digital and photonics application software.

In the automotive and energy market, we continue to make great strides. Customer demand remained high in Q1, and we delivered our ninth consecutive quarter of double-digit order growth. Auto manufacturers and suppliers have continued to invest in critical new capabilities, and are increasingly turning to Keysight as their strategic innovation partner. As a result, we continue to grow our engagements within top customers and add new tier-1 accounts. In the quarter we announced a collaboration with BMW Group to support its Battery Cell Competence Center in Munich. Keysight will equip their laboratories with battery test systems and provide services for effective laboratory workflow management and operation. In order to help our automotive customers accelerate innovation, we are committed to serving them in close proximity of their design hubs. In January, we opened a new automotive customer center in Nagoya, Japan. Keysight has now opened four automotive customer centers aligned with each of the major global automotive customer ecosystems: Detroit, Michigan, in the U.S.; Boeblingen, Germany in Europe; and, Nagoya, Japan and Shanghai, China in Asia.

In 5G, we achieved another record quarter of 5G orders and delivered strong double-digit growth in Q1. Network operators, NEMs, device-makers, and chipset companies are all investing for the early ramp of commercial 5G networks. Our broad portfolio of 5G solutions and engagement with leading market makers continues to strengthen our position in this fast-growing market. Our pace of innovation and engagements has accelerated, and we continue to see major operator ecosystems embrace the Keysight platform. This quarter we received endorsements from SK Telecom, China Telecom, China Mobile and Softbank.

Next week at Mobile World Congress, we will showcase our end-to-end 5G solutions and contributions. At the event, over a dozen leading innovators across the communications ecosystem will use Keysight’s solutions to demonstrate their 5G readiness. This highlights the greater role we are playing in R&D and enabling customer innovation. We are also excited to collaborate with Xilinx, AT&T and others to accelerate Open RAN 5G network development through a rapid prototyping approach and open FPGA architecture. Together, at Mobile World Congress, we will demonstrate and test the industry's first open radio access network 5G millimeter wave radio unit.

Additionally, earlier today we announced our new scalable 5G User Equipment Emulation solution. It delivers end-to-end testing of 5G networks to ensure they can meet service level agreements for key 5G use cases, such as low-latency and high-reliability. This solution expands the range of our 5G offerings into a previously unserved area for Keysight, which is the direct result of our acquisition of Ixia.

Beyond 5G, our communications group also delivered strong growth in Network and Data Center solutions. This growth was driven by R&D investment in next-generation electrical and optical test for speeds of 400G and higher, with key new product wins throughout the network and data center ecosystem. Our success with 400G at the physical layer, creates valuable opportunities for our 400 gigabit Ethernet solutions at the protocol layers with Ixia, where customers' R&D investments follow over time. Keysight's solutions cover the entire customer workflow in both the physical and upper layers of the network.

Looking ahead, we believe we are well-positioned to continue to build on our success. Next-generation R&D investment has remained strong, and we are still in the early stages of these emerging technologies.

Our focus on bringing solutions to market that help customers accelerate innovation is driving multiple avenues of growth. We have a differentiated portfolio of solutions across a diversified and broad set of end markets. For example, as we mentioned the past two quarters, we are seeing some expected headwinds in China as a result of global trade tensions, which we expect to continue in 2019. Despite this dynamic, our breadth of offering and diverse set of end-markets has enabled us to offset this impact and deliver record orders in China during the quarter, with growth in multiple segments of that market. That said, we continue to closely monitor the macro environment in China, as well as other areas of our business.

Before closing, I will highlight a few of the awards we recently received in acknowledgement of our corporate social responsibility, or CSR, efforts, which is one of the core values in our Keysight Leadership Model. First, Keysight was ranked among Barron's 100 Most Sustainable Companies for the second year in a row. Additionally, we were named to Fortune's 100 Best Workplaces for Diversity in 2018. CSR has always been a part of Keysight's DNA and we are honored to be recognized for this longstanding commitment to help sustain a better planet, strengthen communities, and create an inclusive work environment that fosters respect for individuals, their ideas and their contributions.

In summary, we delivered an outstanding first quarter and the year is off to a great start for Keysight. In addition to driving strong revenue growth, we have maintained our focus on financial discipline and operational excellence to deliver earnings growth and strong cash flow while investing in key areas of the business. With our robust innovation engine, we have built a broad portfolio of solutions that span multiple segments, and software is becoming a larger part of our differentiation and business. We will continue to focus our investments in these key areas to drive innovation, create even more value for our customers and outgrow the market.

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

**NEIL DOUGHERTY**

Thank you, Ron, and hello, everyone. Before I get started, I will note that all comparisons are on a year-over-year basis unless specifically noted otherwise. Additionally, when viewing our first quarter year-over-year operational compares, please keep in mind that last year's first quarter results were negatively impacted by the closure of our Santa Rosa facility due to the 2017 wild fires.

As Ron mentioned, we delivered another strong quarter as we continued to execute on the demand we see in core areas of our business, while maintaining focus on operational excellence.

For the first quarter of 2019, we delivered non-GAAP revenue of $1 billion 9 million dollars, which was well above our guidance of 965 million to 985 million dollars, and grew 20 percent on a core basis versus a soft compare. Our better than expected results were driven by continued strong demand and execution.

Orders exceeded revenue once again this quarter. We delivered $1 billion 16 million dollars in orders in Q1. Orders were up 5 percent in total, and 7 percent on a core basis, which excludes the impact of currency movements and two small divestitures completed within the last year.

Looking at our operational results for Q1, we reported record gross margin of 62 percent and operating expenses of $420 million, resulting in operating margin of 20 percent. We also achieved net income of $176 million and delivered 93 cents in earnings per share, which was above our guidance of 76 to 82 cents per share. Our weighted average share count for the quarter was 190 million shares.

Moving to the performance of our segments, as Jason mentioned, we made a change to our reporting segments and now results from services, which was previously in our Services

Solutions Group (SSG), are reported in the segment in which the services are delivered. That said, I will highlight that in Q1, orders for services grew double-digits.

Our Communications Solutions Group generated total revenue of $623 million, up 25 percent, while delivering record gross margin of 61.1 percent and operating margin of 22 percent. In Q1, Commercial Communications delivered double-digit order growth and revenue of $400 million, driven by increased 5G R&D demand across the wireless ecosystem and growth in data center related next-generation 400 gigabit Ethernet and higher digital test. Aerospace, defense and government grew 3 percent and generated revenue of $223 million. Aerospace defense and government growth was driven by continued demand in space and satellite applications in the U.S., while spending in some international regions slowed.

Our Electronic Industrial Solutions Group, or EISG, generated first quarter revenue of $257 million, up 13 percent, driven by strength in automotive and emerging IoT applications, while the semiconductor market moderated as expected. EISG reported gross margin of 58.9 percent and operating margin of 21 percent.

Our Ixia Solutions Group, or ISG, reported Q1 revenue of $129 million, which was slightly above last year's revenue of $127 million, driven by network visibility solutions, while test revenue remained inline with last year. ISG reported gross margin of 71.3 percent and 9 percent operating margin. We were encouraged to see the improved sequential execution in ISG, and the vast majority of the contract manufacturing transition issues that we highlighted last quarter are now resolved.

Moving to the balance sheet and cash flow, we ended our first quarter with $1.1 billion in cash and cash equivalents and reported record cash flow from operations of $240 million and free cash flow of $209 million, or 21 percent of revenue.

Under our existing share repurchase authorization, during the quarter we acquired approximately 686,000 shares on the open market, at an average price of $58.28, for a total consideration of $40 million.

**Now, turning to our outlook and guidance …**

We expect second quarter 2019 revenue to be in the range of 1 billion 60 million to 1 billion 80 million dollars. For the first half of 2019, the midpoint of our guidance reflects 12 percent revenue growth or 14 percent core growth. We expect Q2 earnings per share to be in the range of 93 to 99 cents, based on a weighted diluted share count of approximately 191 million shares. The midpoint of this guidance reflects approximately 41 percent earnings growth for the first half of 2019.

For 2019 modeling purposes, recall that the quarterly revenue seasonality in 2018 was atypical due to the impact of the October 2017 northern California wild fires. Historically, sequential revenue growth from Q1 to Q2 has averaged mid-single digits and our Q2 guidance reflects the upper end of this range. Additionally, we normally see a small sequential decline from Q2 to Q3, with Q4 being our strongest quarter of the year.

I will also note that in Q1, the ASU 2017-07 pension accounting change went into effect. Under this new standard, a previous credit functionalized within operating income is now reported in other income. For 2019, the impact of this change is projected to shift a credit of approximately $10 million per quarter from above the operating margin line to below. A retrospective of our historical results reflecting the new standard can be found on our website.

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?