NETSCOUT

NETSCOUT SYSTEMS, INC.
Second Quarter Fiscal Year 2025 Financial Results Conference Call
Management's Prepared Remarks

October 24, 2024

Slide #2: Introduction
Tony Piazza:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's second -quarter fiscal year 2025 conference call for the period ended September 30, 2024. Joining me today are:

- Anil Singhal, NETSCOUT's President and Chief Executive Officer,
- Michael Szabados, NETSCOUT's Chief Operating Officer, and
- Jean Bua, NETSCOUT's Executive Vice President and Chief Financial Officer.

There is a slide presentation that accompanies our prepared remarks. You can advance the slides in the webcast viewer to follow our commentary. Both the slides and the prepared remarks can be accessed in multiple areas within the investor relations section of our website at www.netscout.com, including the IR landing page under financial results, the webcast itself, and under financial information on the quarterly results page.

Slide #3: Safe Harbor Statement

Moving on to slide number 3, today's conference call will include forward-looking statements. Examples of forward-looking statements include statements regarding our future financial performance or position, results of operations, business strategy, plans and objectives of management for future operations, and other statements that are not historical fact. Actual results could differ materially from any forward-looking statements. These statements speak only as of today's date and involve risks and uncertainties, including but not limited to those described on this slide and in today's financial results press release, which are available on the Investor Relations section of our website, as well as in the Company's most recent Annual

Report on Form 10-K and subsequent SEC filings, on file with the Securities and Exchange Commission. NETSCOUT assumes no obligation to update any forward-looking information except as required by law.

Slide #4: Non-GAAP Reconciliation

Let's now turn to slide number 4, which involves non-GAAP metrics. While this slide presentation includes both GAAP and non-GAAP results, unless otherwise stated, financial information discussed on today's conference call will be on a non-GAAP basis only. The rationale for providing non-GAAP measures along with the limitations of relying solely on those measures is detailed on this slide and in today's press release. These measures should not be considered in isolation from or as a substitute for financial information prepared in accordance with GAAP.

Reconciliations of all non-GAAP metrics with the applicable GAAP measures are provided in the appendix of the slide presentation, in today's earnings press release, and on our website.

I will now turn the call over to Anil for his prepared remarks. Anil…

Slide #5: CEO Perspective
Anil Singhal:

Thank you, Tony, and good morning, everyone. Welcome and thank you all for joining us today.

We delivered Q2 fiscal year 2025 revenue and earnings results in line with our expectations as we continue to position NETSCOUT to win in the market. We remain confident that our differentiated solutions are well-positioned to address our customer's cybersecurity and service assurance needs well into the future. During the quarter, we released several product enhancements aligned with key technology trends that help address our customers' cybersecurity and service assurance needs, including our AI-Ready Smart Data solution. We also had a strong turnout and interest at our recent annual ENGAGE Technology and User Summit that we attribute to our customers' enthusiasm for our current and upcoming portfolio of solutions. Looking ahead, we remain focused on executing against our full fiscal year 2025 non-GAAP expectations as we capitalize on opportunities and navigate the challenges of the current market environment.

Let's turn to slide number 6 for a brief recap of our non-GAAP financial results for the second quarter and first half of our fiscal year 2025.

Slide #6: Q2 and 1H FY'25 Non-GAAP Financial Results

For the second quarter:

- Revenue was approximately 191 million dollars, down approximately 3 percent compared to the prior year period. The comparison was impacted by two items that benefitted the prior year period - approximately 11 million dollars of backlog-related revenue and approximately 3 million dollars for the now divested Test Optimization business. Normalizing for those, Q2 revenue would have grown at a mid-single digit percentage.
- Diluted earnings per share was 47 cents for the second quarter, which was down approximately 23 percent or 14 cents from the prior year. As we previously noted,

this includes an approximately 15 cent headwind from the reversal of incentive-related expenses that benefitted last year's Q2. Normalizing for this, Q2 earnings would have been slightly higher year-over-year, even after absorbing the 2 cent impact from an unrealized foreign investment loss.

- For the first half of the fiscal year, or the six-month period ended September 30, 2024,
  - Revenue was approximately 366 million dollars, down approximately 10 percent year over year, primarily due to the unusually high levels of backlog related revenue that benefited last year, as well as the aforementioned Test Optimization divestiture. Normalizing for these factors, our first half revenue would have grown low-single digits year-over-year due to solid order flow growth.
  - The corresponding diluted earnings per share for the first half of 75 cents was a decrease of approximately 18 percent year-over year. Normalizing for the previously mentioned incentive-related expense headwind alone, our first half EPS would be relatively consistent year-over-year as cost management measures and a gain on a foreign investment helped to offset the revenue headwind impacts.

Now, let's move to slide 7 for some further perspective on business and market insights.

Slide #7: Business and Market Insights

Service Assurance

Starting with our Service Assurance offerings, revenue for the first half of fiscal year 2025 was down approximately 13 percent year-over-year. The decline was largely attributable to the backlog-related revenue headwind and the constrained spending environment primarily from the service provider element of the market.

Importantly though, carriers continue to invest in their 5G initiatives domestically and internationally, at a measured pace as they manage investments against monetization opportunities. On the enterprise front, we also see spending scrutiny but maintain traction and remain confident that, as customers advance their digital transformation initiatives NETSCOUT is well positioned to win additional business by leveraging our value proposition of extending visibility to the edges of the network. Additionally, as customers advance their AI initiatives, we believe our new AI-Ready, high quality Smart Data will be invaluable to ensure unique and deep insights critical for enabling organizations to improve decision-making and optimize the user experience.

Cybersecurity

Moving to our Cybersecurity offering, revenue in the second quarter increased approximately 3 percent, and was down approximately 4 percent for the first half primarily due to the backlog-related headwind. Cybersecurity continues to represent a strong growth opportunity for NETSCOUT as customers prioritize spending to protect themselves from the expanding cyber threat landscape. This was validated by our recently released first-half 2024 Threat Intelligence Report, where we highlighted that the surge in DDoS attacks and hacktivist activity continues to threaten critical global infrastructure including banking, financial services, government, and utilities. The report points to a dramatic 43% increase in the number of application-layer attacks and a 30% increase in volumetric attacks.

Michael will provide more insight regarding customer wins in our offering areas during his remarks.

Now, let's move to slide number 8 to review our outlook.

Slide #8: FY'25 Outlook & Summary

Looking ahead, we are reaffirming our full fiscal year 2025 non-GAAP revenue and EPS outlooks. Jean will provide a recap of the outlook in her remarks.

As we navigate both the opportunities and challenges of the current market environment, we remain focused on executing against our full fiscal year 2025 expectations as we advance our strategic priorities. These include enhancing our cybersecurity offerings to meet growing customer needs, given the expanding cyber threat landscape, and continuing to prudently manage costs. During the first half of the fiscal year, we completed the majority of the previously announced voluntary separation program. We expect this to have a benefit of approximately 25 million dollars of annualized cost reductions, a portion of which will be recognized during fiscal year 2025. Longer term, we remain committed to leveraging our 'Visibility Without Borders' platform to help customers address the performance, availability, and security challenges of the complex digital world.

We look forward to sharing our progress with everyone throughout the remainder of our fiscal year.

With that, I'll turn the call over to Michael.

Slide #9: COO Update

Michael Szabados:

Thank you, Anil, and good morning, everyone. Slide 10 outlines the areas I will be covering today, starting with Q2 customer win highlights:

Slide #10: COO Highlights

Customer Wins:

This quarter, I will begin by focusing on a high-single digit eight figure combination of orders from a leading global financial institution that spanned both our Service Assurance and Cybersecurity product lines. This has been a long-standing customer of ours who uses our Service Assurance solutions to manage the performance of their networks and customer-facing applications in order to ensure the quality of their customers' experience. They leverage our Cybersecurity solutions to protect the availability of their infrastructure against DDoS attacks, to prevent disruption to their digital services. In both product lines, they upgraded and expanded our solutions to ensure they had the most current technological capabilities, such as Adaptive DDoS in security, to assure and secure their network. We were awarded this additional business due to our proven technology, outstanding customer support, and trusted long-standing relationship.

Go-to-Market Activities:

Turning to our go-to-market activities.

As Anil stated, we recently released our 1H 2024 DDoS Threat Intelligence Report. The report provided significant insight into the evolving cybersecurity landscape, leveraging our visibility into nearly half of all internet traffic. Additionally, since our last earnings call, we have announced several product advancements. This includes the release of our Omnis AI Insights solution to deliver high-quality, actionable AI-Ready steaming smart data, based on deep packet inspection technology, to feed customer AI initiatives and enable critical insights and outcomes. We also announced the update of our advanced, scalable deep packet inspection-based Omnis Cyber Intelligence Network Detection and Response (or NDR) platform which now has additional behavior analytics to enable earlier detection of advanced threats.

Finally, we recently hosted our Annual ENGAGE Technology and User Summit in Arlington, TX. It was another successful event with strong attendance and interest in our new technology initiatives. At the show, we highlighted our upgraded legacy and new solutions, and showcased how our highly curated dataset can solve security, observability, and service assurance problems faster when integrated with AIOps platforms from our industry leading partner network, including Splunk and ServiceNow, who co-presented with us and engaged with our customer attendees. We also conducted our typical combination of presentations, panel discussions, solution demonstrations, and hands-on training.

Thank you, everyone. That concludes my remarks, and I will now turn the call over to Jean.

Slide #11: CFO Financial Review

Jean Bua:

Thank you, Michael, and good morning, everyone. I will review key metrics for our second quarter and first half of fiscal year 2025 and provide some additional commentary on our fiscal year 2025 outlook. As a reminder, this review focuses on our non-GAAP results unless otherwise stated, and all reconciliations with our GAAP results appear in the presentation appendix. Regardless, I will note the nature of any such comparisons. Additionally, all comparisons are on a year over year basis unless otherwise noted.

Slide #12: Q2 FY'25 Results

Slide number 12 details the results for the second quarter and first half of fiscal year 2025. Focusing on our quarterly performance, total revenue for the second quarter of fiscal year 2025 was 191.1 million dollars, down 2.9 percent. As Anil shared, our Q2 fiscal year 2025 revenue would have grown at a mid-single digit percentage when normalizing for the 11 million dollars in backlog usage and 3 million dollars for the disposition of our Test Optimization business that took place last year. Product revenue of 81 million dollars, was up 0.6 percent year over year. Service revenue was 110.1 million, a decrease of 5.3 percent, which was primarily due to the timing of the renewal of a large customer's maintenance contract that is expected to close in Q3.

Gross profit margin was 79.7 percent in the second quarter, down 0.6 percentage points. Quarterly operating expenses increased 5.2 percent in comparison to the prior fiscal year, which benefited from the reversal of incentive-related expenses. Normalizing for this, operating expenses would have declined mid-single digits primarily attributable to cost management initiatives including the Voluntary Separation Program. We reported an operating profit margin of 23.1 percent in Q2 fiscal year 2025 compared with 28.0 percent in the same quarter last year.

Diluted earnings per share was 47 cents, which included an unrealized loss on a foreign investment of approximately 2 cents. This was down 23 percent from 61 cents in the same quarter last year due to the incentive-related expense reversals in the prior period as well as the unrealized investment loss.

Slide #13: 1H FY'25 Revenue Trends: Product Lines and Customer Verticals

Turning to slide 13, I will review key revenue trends by product lines and customer verticals. Please note that all comparisons here are on a year-over-year basis, consistent with our other remarks. As a reminder, we entered the prior fiscal year with approximately 48 million dollars of backlog which we did not get the benefit of this fiscal year.

For the first half of fiscal year 2025, our Service Assurance revenue decreased by 13.5 percent, while our Cybersecurity revenues decreased by 3.9 percent. During the same period, our Service Assurance product line accounted for approximately 65 percent of our total revenue, while our Cybersecurity product line accounted for the remaining 35 percent.

Turning to our customer verticals. For the first half of fiscal year 2025, our enterprise customer vertical revenue was consistent while our service provider customer vertical revenue decreased 22.2 percent. During the same period, our enterprise customer vertical accounted for approximately 60 percent of our total revenue, while our service provider customer vertical accounted for the remaining 40 percent.

Slide #14: FY'25 Revenue Trends: Geographic Mix

Turning to slide 14, this shows our geographic revenue mix. For the first half of fiscal year

2025, 58 percent of our revenue was derived from the United States, with the remaining 42 percent provided by international markets. Also, no customer represented 10% or more of our total revenue in the second quarter or the first half of fiscal year 2025.

Slide #15: GAAP Balance Sheet & Free Cash Flow Review

Slide 15 details certain balance sheet and free cash flow items. We ended the second quarter with 401.9 million dollars in cash, cash equivalents, short- and long-term marketable securities, and investments, representing a decrease of 22.3 million dollars since the end of fiscal year 2024. Free cash flow for the quarter was a use of 5.8 million dollars. During the second quarter of fiscal year 2025, we repurchased approximately 14 thousand shares of our common stock for approximately 257 thousand dollars or an average price of 18 dollars per share. We currently have capacity in our share repurchase authorization and, subject to market conditions, intend to be active in the market during the balance of the fiscal year.

From a debt perspective, we ended the second quarter of fiscal year 2025 with 75 million dollars outstanding on our revolving credit facility. In October, we leveraged the favorable financing market environment to amend and extend our credit facility. The amended revolving credit facility reduces the facility size from 800 million dollars to 600 million dollars and extends the maturity from July 2026 to October 2029, while maintaining financial flexibility and lowering financing costs.

To briefly recap other balance sheet items, accounts receivable, net, was 118.6 million dollars, representing a decrease of 73.5 million dollars since March 31, 2024. The DSO metric at the end of the second quarter of fiscal year 2025 was 53 days, versus 69 days for the same period in the prior year, and 81 days at the end of fiscal year 2024. The lower DSO metric in the second quarter of this fiscal year was due to the timing and composition of bookings.

Slide #16: FY'25 Outlook

Let's move to slide 16 for commentary on our outlook. I will focus my review on our non-GAAP targets for fiscal year 2025.

FY'25 Outlook

As Anil noted earlier, we are reaffirming our non-GAAP outlook for fiscal year 2025 that was presented during our July 25, 2024, first quarter earnings call. As a reminder, for fiscal year 2025, we anticipate revenue in the range of 800 million to 830 million dollars. Additionally, we continue to anticipate non-GAAP diluted earnings per share within the range of 2 dollars and 10 cents to 2 dollars and thirty cents, with the mid-point consistent year over year. The full year effective tax rate is expected to be approximately 20 percent. Our weighted average diluted shares outstanding is assumed to be approximately 73 million shares, which incorporates our recent share repurchase activity but does not assume any further repurchase activity. Finally, given that we are only halfway through the fiscal year, any further impact associated with the previously mentioned foreign investment, which currently reflects a year-to-date unrealized gain, will be evaluated as the fiscal year progresses as its value and therefore impact to our outlook fluctuates.

Our fiscal year 2025 non-GAAP guidance also reflects the anticipated benefits associated with the previously mentioned Voluntary Separation Program restructuring actions and ongoing cost management initiatives. In conjunction with these actions, we recorded GAAP restructuring charges in the first half of fiscal year 2025 attributable to one-time separation payments of 19 million dollars, 2.4 million of which was in the second quarter. We expect to record an additional restructuring charge of approximately 0.6 million dollars in the third quarter of fiscal year 2025 primarily for severance costs associated with the remaining implementation of the current VSP. We expect that these actions will generate annual run-rate savings of approximately 25 million dollars, of which approximately 19 million dollars will be realized in fiscal year 2025 due to the timing of these actions.

Finally, I would like to provide some "color" for the second half of fiscal year 2025. Consistent with the expectations that we shared on our last earnings call, we anticipated a revenue skew of approximately 45 percent in the first half of the fiscal year and 55 percent in the second half of the fiscal year. We expect the remaining 55 percent of the full fiscal year's revenue to essentially be split evenly between the third and fourth quarters. We also expect the corresponding non-GAAP earnings per share to be split evenly between the third and fourth quarters.

That concludes my formal review of our financial results. Before we transition to Q&A, I'd like to quickly note that our upcoming IR conference participation is listed on slide 17. Thank you, and I'll now turn the call over to the operator for questions.