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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to NetScout's second quarter of fiscal year 2013 operating results conference call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be given to you at that time. As a reminder, this conference call is being recorded.

With us today is NetScout's President and CEO, Mr. Anil Singhal. He is accompanied by NetScout's Chief Operating Officer, Mr. Michael Szabados, and NetScout's Chief Financial Officer, Ms. Jean Bua. At this time, I will turn the call over to Ms. Cathy Taylor, NetScout's Director of Investor Relations, to provide the opening remarks. Ms. Taylor, please proceed.

Cathy Taylor - *NetScout Systems Inc. - IR Director*

Thank you and good morning everyone. Welcome to NetScout's fiscal 2013 second-quarter conference call for the period ended September 30.

Before we begin, let me remind you that, during the course of this conference call, we will be providing you with a discussion of the factors that we currently anticipate may influence our results going forward. These statements include forward-looking statements made pursuant to the Safe Harbor provisions of Section 21-E of the Securities Exchange Act of 1994 and other federal securities laws. These forward-looking statements may involve judgment and individual judgments may vary. Forward-looking statements include expressed or implied statements regarding future economic and market conditions, guidance for fiscal year 2013, acquisition integration success and new product releases. It should be clearly understood that the projections on which we base our guidance and other forward-looking statements and our perception of the factors influencing those projections are highly likely to change over time. Although those projections and the factors influencing them will likely change, we will not necessarily inform you when they do.

Our Company policy is to provide guidance only at certain points in the year, such as during the quarterly earnings call. We do not plan to update that guidance otherwise. Actual results may differ materially from what we say today, and no one should assume later in the quarter that the comments we make today are still valid. For the further discussion of the risks and uncertainties that could cause our actual results to differ, see the specific risks and uncertainties discussed in NetScout's annual report on Form 10-K for the year ended March 31, 2012 on file with the Securities and Exchange Commission.

Our quarterly financial results are included with our earnings press release. We report our results on a GAAP basis as well as on a non-GAAP basis. Our non-GAAP results eliminate the GAAP effects of our acquisitions by adding back revenue related to deferred revenue revaluation and removing expenses related to the amortization of acquired intangible assets, the GAAP effects of stock-based compensation and restructuring charges. Our non-GAAP results also exclude certain expenses relating to our acquisitions, including compensation for post-combination services and business development charges. We exclude the related impact of all these adjustments on the provision for income taxes. The differences between GAAP and non-GAAP are disclosed in the reconciliation tables in the press release. We believe these adjusted financial measures will enhance your overall understanding of recurrent financial performance and our prospects for the future. We use these adjusted financial measures internally for the purpose of analyzing, managing, and forecasting our business.

We have included on today's webcast a slide presentation that provides a summary of key financial data that accompanies the financial section of today's discussion. For those listeners who have dialed into the call this morning and would like to view this presentation, you can find it by going to our website at www.NetScout.com/investors, and then clicking on today's webcast.

I will now turn the call over to Anil Singhal, our Chief Executive Officer.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Thank you Cathy. We are very pleased to report solid results for the second quarter of fiscal year 2013.

Our non-GAAP revenue grew 17% to $84.7 million, while our non-GAAP earnings per share grew 42% to $0.34 this quarter compared to the same period of the last fiscal year. Jean will discuss our second-quarter comparison in more detail later in the call.

More importantly, looking at the results of the first half -- first half of the fiscal year 2013, we are very well-positioned to deliver on the full-year guidance we provided at the beginning of the fiscal year. First half non-GAAP revenue was $161.2 million, an increase of 19% from the last fiscal year. Our first-half non-GAAP earnings per share was $0.33, which is a $0.43 increase -- 43% increase from the prior year. In addition, we are entering the third quarter with one of our highest backlogs ever historically of over $90 million.

During the first half, the new business bookings component, which is a leading indicator of our business growth, was up 15%. New business bookings from service providers remain strong and we continue to win significant new projects as wireless carriers adopt our market-leading IP solution. We are on track with the integration of the technology that we acquired from Accanto Systems in July. Accanto's voice services unit (inaudible) [logistics] with a (inaudible) strategy and bring important voice service monitoring for both legacy voice environment and next generation network voice services. With this technology, we will be able to offer both existing and new customers a robust set of legacy and next-generation voice service management capabilities in a single vendor solution, giving us an increasingly strong position to compete for business in Tier 2 wireless carriers worldwide where demand for a single vendor solution is high.

Our strategy remains focused on expanding our technology leadership in IP-based packet-switched environments to monitor and capture all traffic traversing a single link using a single probe and provide the lowest total cost of ownership to our customers. We will share our product integration process and go-to-market strategy later this year.

Further in the service provider space, we signified our growing focus on the cable MSO vertical with our inaugural participation in the FTP Cable Tech (inaudible) this week where we announced our solution to address the service delivery management needs of cable MSOs globally. NetScout provides MSOs, which is multiple system operators, with real-time end-to-end visibility into the IP infrastructure that facilitates the delivery of next-generation business and consumer services. We are building on our already strong momentum -- momentum in the mobile operator segment and NetScout has also achieved deployment with five top-tier MSOs in North America, Europe and Asia.

I'm also pleased to note that, based on our research, we believe that our continued success has earned us the leading market share in the IP-based segment of the service provider market.

Many of our customers are experiencing challenging global economic conditions. Despite these conditions in our financial and general enterprise verticals, we have seen new business growth of 4% in Financial Services and 2% in the general enterprise sector for the first half of fiscal year '13. Selected domestic bid customers are performing hardware upgrades, extending coverage of their existing infrastructure, as well as adopting our technology for unified service delivery. We expect that the global economic conditions will remain the same for the foreseeable future.

Our government customers are also facing the uncertainty of the upcoming fiscal year spending. Our customers have engaged in long-term strategic projects that require multiple funding [strap] along their time line. While our pipeline for the government show demand from our customer base, ultimate funding did not happen. On a first half basis, our government verticals new business bookings declined 32%.

We continue to invest in extending the reach of our solutions within the enterprise to address the new challenges presented by cloud-based services and the proliferation of bring your own device, or BYOD, mobile devices expected to delever enterprise class services. NetScout unified service delivery management solutions address the needs of the emerging new environment and provide service assurance and performance management solution at scale across the entire enterprise.

In summary, we have continued to enhance our nGenius Service Assurance Solution to serve the needs of our global customer base. Based on our first-half results, we are reaffirming our non-GAAP revenue guidance range of $340 million to $355 million, and are raising the low end of our GAAP and non-GAAP EPS guidance by $0.03. The revised GAAP EPS range is $0.94 to $1 and the non-GAAP EPS range is now $1.24 to $1.30.

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

Michael Szabados - *NetScout Systems Inc. - COO*

Thank you. In my comments, I will focus on our execution and operational performance this past quarter.

From a product development perspective, we are continuing to enhance our nGenius Service Assurance Solution to serve the needs of our customers. During the quarter, we released an important set of enhancements and upgrades to our nGenius suite of products in support of our unified service delivery management, or USDM strategy. Key deliverables included continued enhancement of our service provider Service Assurance offering in support of operations in wireless carrier LTE networks. We also delivered to our enterprise customers additional integration of our nGenius voice and video functionality across the nGenius product suite, as well as integrating our Packet Flow Switch product line into nGenius Performance Manager.

We also delivered additional ASI data sets supporting both service providers and enterprise customers. While our federal business has been impacted by spending concerns, we continue to invest in our ability to service our federal government customers and have successfully differentiated our solutions through extensive certification and accreditation work.

Most recently, our nGenius Service Assurance Solution has been certified by the Defense Information Systems Agency, or DISA, for the Department of Defense unified capabilities approved product list and approved by the National Information Assurance Partner as Common Criteria Certified at Evaluation Assurance Level 3, EAL 3. These certifications validate that the nGenius Service Assurance Solution meets the rigorous testing and technical requirements for interoperability and security mandated by the DOD, National Institute of Standards and Technology, and National Security Agency.

In the Enterprise segment, we are continuing our strategy of unified service delivery management aimed at consolidating multiple IT operations, capabilities around the common Packet Flow platform. We are gaining increasing traction with our new Packet Flow Switch and unified communications solution sets. These offerings are both increasing the value of our in-stock instrumentation, and giving us access to new budgets. With these offerings and the increased capabilities being developed in USDM, NetScout will continue to increase its portfolio of products for our enterprise customers to further expand our long-standing leadership position.

Let me highlight two specific examples that illustrate our strategy has produced results without the enterprise customers in our fiscal second quarter. One of our large banking customers, in consolidating and upgrading their data centers to better support their new IT services such as mobile banking, have continued to depend on NetScout as their Service Assurance platform. This past quarter, they placed a large order in excess of $1 million to expand their NetScout instrumentation.

Another example is a deal over $1 million from a Fortune 100 manufacturing company. Our success with this customer was spearheaded by their need for Service Assurance of their initial deployment of Microsoft Lync collaboration tools. There, our Unified Communication solution was the right answer. In the course of planning the deployment of our UC solution, we were able to identify and bring additional Service Assurance business from other IT operations teams inside the Company, validating our USDM value proposition.

We have achieved some new milestones in our continued investment in sales productivity and effectiveness as well. This past quarter, we completed the development and successful deployment of our new CRM solution. We also trained our worldwide sales force in consistent selling methodology and solution positioning to accelerate success with our global customer base.

In sharpening our focus on our two markets, we continue to grow our service provider and enterprise expertise centers that drive shared learnings, knowledge transfer, and provide overlay sales support to increase our rate of success in many top growth opportunities.

Further, we have completed the alignment of EMEA sales with these two segments, the Service Provider and Enterprise segments are also averaging the new sales talent from the Accanto acquisition.

Finally, during the quarter, we won a number of awards, and here are some of the more notable ones that I'd like to share with you. NetScout received the 2011 Product of the Year award for nGenius Service Assurance Solution from TMC and Crossfire Media, the sponsors of Mobility Tech Zone. We were awarded for delivering one of the most innovative products of 2011 and for leadership in the mobile broadband industry. We also received a Communication Solutions Product of the Year from TMC. NetScout was honored for vision and excellence in advancing voice, data and video communications solutions and leadership in the communications industry.

I would now like to turn the call over to Jean for the financial discussion.

Jean Bua - *NetScout Systems Inc. - CFO*

Thank you, Michael, and good morning everyone. As Cathy said earlier, we have a slide presentation to accompany this section of the call. You may feel free to follow along with the slides as I speak. However, I will discuss my results without needing to reference the slides.

We will be starting with the third slide, which shows our second-quarter income statement. As Anil outlined, our business produced solid results for the second quarter of fiscal year 2013.

Our non-GAAP revenue grew 17% while our non-GAAP earnings per share grew 42%. Our second-quarter non-GAAP total revenue was $84.7 million, which is an increase of 17% from the same quarter in fiscal year '12.

Within non-GAAP total revenue, non-GAAP product revenue was $46.2 million, which is an increase of 21% over the same quarter in fiscal year '12. Service revenue was $38.5 million on a non-GAAP basis which is an 11% increase from the same quarter in the prior year.

The GAAP total revenue for the same period was $84.5 million, which is an increase of 16% from the same quarter of fiscal year '12. Within GAAP total revenue, GAAP product revenue was $46.2 million, which is an increase of 21% over the same quarter prior year.

Service revenue was $38.4 million on a GAAP basis, which is an 11% increase from the same quarter in the prior year.

On a non-GAAP basis, earnings per share for the second quarter were $0.34. This is $0.10 higher than the second quarter of fiscal year '12 and represents a 42% increase.

On a GAAP basis, our earnings per share were $0.23. This is $0.06 higher than the second quarter of fiscal year '12 and represents a 35% increase.

Turning to Slide 4, the business maintained strong gross profit margins and growing operating margins. On a non-GAAP basis, our gross profit was $69.4 million, representing an 81.9% margin. This margin is 1.7 percentage points higher than the same quarter from the prior year. Our GAAP gross profit for the quarter was $67.6 million and GAAP gross margin was 80%.

Non-GAAP income from operations was $23.8 million. Our non-GAAP operating margin for the quarter was 28%, which is a 5.4 percentage point increase from the same quarter of prior year driven by the 17% revenue growth. GAAP income from operations was $16.9 million. GAAP operating margin was 20%, which is a 4.2 percentage point improvement over the same quarter in the previous year.

Non-GAAP net income was $14.4 million, or $0.34 per diluted share. The non-GAAP net income after tax margin was 17.1%, which is up 2.9 percentage points from a year ago.

GAAP net income for the quarter was $9.9 million, yielding earnings per diluted share of $0.23. GAAP net income after-tax margin was 11.7%, which is an increase of 2 percentage points from a year ago.

The major difference between our non-GAAP and GAAP income from operations for the quarter is the exclusion of stock-based compensation for $2.5 million and about $3 million of costs associated with our acquisitions, which includes amortization of intangibles for $2.1 million, business development expenses totaling $500,000, and $1.2 million for restructuring charges. These are detailed in our reconciliation of our non-GAAP to GAAP results presented in our press release.

The quarter's provision for income taxes is recorded based upon a full-year tax rate of 36.3% on a GAAP basis. Our GAAP tax rate for the quarter is 40.9%. Consistent with past practice, we have used the statutory tax rate of 38% to tax affect the non-GAAP adjustment. The adjustments reconciling our non-GAAP results to our GAAP results are summarized in the reconciliation table included with our press release.

Turning to Slide 5 which shows our total bookings and new business bookings component, total bookings in Q2 were $86.8 million, a slight decrease of $1.4 million, or 2%, year-over-year. Within total bookings, our new business bookings were $70.2 million, an increase of $2.1 million or 3% over the prior-year second quarter.

Service contract renewal bookings in the quarter were $16.5 million, a decrease of $3.6 million, or 18%, year-over-year. Product backlog at the end of the quarter was $19.5 million.

The components of our new business bookings for the second quarter of fiscal year '13 were as follows -- service providers, 47%; financial enterprise, 24%; government enterprise, 10%; and general enterprise, 19%. This compares with the prior year quarter's new business booking component as follows -- service provider, 22%; financial, 32%; government, 25%; enterprise, 21%.

Slide 6 is a -- that was general enterprise, 21%.

Slide 6 is a summary of our deals for this quarter. For large deals within the quarter, 142 customers gave us orders over $100,000, in comparison to 152 customers from last year. We received 13 orders over $1 million, of which five came from service providers, four from financial services, two from government, and two from general enterprise. This compares to 14 orders over $1 million that we received last year in the second quarter. Last year's orders that were greater than $1 million included five from service providers, five from financial services, two from government, and two from general enterprises.

For year-to-date fiscal 2013, Slide 7 shows our results. For the first half of fiscal year '13, non-GAAP revenue was $161.2 million, which is an increase of 19% from fiscal year '12. GAAP revenue for the first half of fiscal year '13 was $160.9 million, which is an increase of 18% from fiscal year '12. Non-GAAP and GAAP product revenue was $86.4 million for the first half of fiscal year '13, an increase of 28% over prior year non-GAAP and GAAP revenue.

Non-GAAP service revenue was $74.8 million and GAAP service revenue was $74.5 million for the first half of fiscal year '13. This is an increase of 9% over prior year for both non-GAAP and GAAP service revenue.

On a non-GAAP basis, our year-to-date gross profit was $130.5 million, representing an 81% margin. This margin was 90 basis points higher than the first half of prior year.

Our GAAP year-to-date gross profit was $127.1 million and GAAP gross margin was 79%, which is 70 basis points higher than the first half of prior year.

Non-GAAP year-to-date income from operations was $37 million. Our year-to-date non-GAAP operating margin was 23% which is 4.6 percentage points higher than prior year.

GAAP year-to-date income from operations was $25.1 million. GAAP operating margin was 15.6%, 4 percentage points higher than the previous year.

On a non-GAAP basis, our year-to-date earnings per share for fiscal year '13 were $0.53. This is $0.16 higher than year-to-date for fiscal year '12 and represents a 43% increase. On a GAAP basis, our year-to-date earnings per share was $0.35.

Turning to Slide 8, which shows our total bookings and new business bookings growth for the first half of fiscal year 2013, total bookings year-to-date for fiscal year '13 was $153.9 million, up $12.9 million on 9% year-over-year. Within total bookings, new business bookings were $121.5 million, up $15.9 million, or 15%, over the prior year. Renewal bookings were $32.4 million, which is a decrease of $3 million or 8%.

In spite of the economic challenges facing our customers across the globe in the first half of fiscal year '13, all of our business verticals experienced growth in new business bookings over the prior year with the exception of government. We believe the decline in the government new business bookings is due to the budget uncertainty around long-term strategic government projects.

Our new business bookings for Service Provider sector grew 70% on a year-over-year basis which was helped by the expansion of LTE deployments by our customers around the globe. Our new business bookings for the financial enterprise sector grew modestly at 4% on a year-over-year basis. Our general enterprise sector grew 2%. The new business bookings for government verticals decreased 32% on a year-over-year, largely due to the federal government deferring spending on long-term strategic initiatives. Our federal government new business bookings decreased 38% while the rest of the government business, which includes foreign governmental agencies and state governmental agencies, decreased 8%.

Slide 9 shows our new business bookings by vertical. The components of our new business bookings for fiscal year '13 were as follows -- service provider, 41%; financial enterprise, 27%; government enterprise, 11%; general enterprise, 21%. This compares with the prior-year new business bookings component as follows -- service provider, 28%; financial enterprise, 30%; government enterprise, 19%; general enterprise, 23%.

Turning to Slide 10%, this is a depiction of our year-to-date revenue by geography. For the first half of the fiscal year, revenue from international sales was 24% of total revenue as compared with 25% of total revenue for fiscal year '12. Within our international sales, Europe delivered 11%, which was consistent with last year. Our Asia sales percent was 5% compared to 6% last year. Our other international sales were 8%, which was the same as last year.

Slide 11 includes highlights from our balance sheet. We continue to maintain strong liquidity. At the end of the quarter, we have invested cash, short-term marketable securities and long-term marketable securities of $235.6 million. This represents an increase of $22.1 million from the prior year end balance of cash and short and long-term marketable securities of $213.5 million. Our year-to-date free cash flow generation of $51.8 million was $39.7 million higher compared to fiscal year 2012.

In this quarter, we repurchased 250,000 shares of treasury stock for $5.9 million. On a year-to-date basis we have repurchased 500,000 shares for $10.9 million.

Accounts Receivable net of allowances was $28.9 million, down from $69.8 million at the end of fiscal year 2012. Days Sales Outstanding were 30 days for the quarter. This is down from 62 days for the second quarter of last year.

Inventories were $8.3 million. This is a $300,000 increase from the fourth quarter of fiscal 2012. Inventory turns were 3.2 times for this quarter versus 2.4 times for the second quarter of fiscal year '12. Additionally, our total deferred revenue was $98 million, which is a decrease of $14 million from fiscal year '12 year-end.

Turning to our guidance for fiscal year '13, Slide 12 illustrates our growth for revenue and earnings per share. For fiscal year 2013, we are reiterating the non-GAAP revenue guidance of $340 million to $355 million and raising the low end of guidance for our non-GAAP net income per share to be in the range of $1.24 to $1.30. For fiscal year 2013, we are reiterating our GAAP revenue guidance of $340 million to $355 million and adjusting our GAAP net income per diluted share to be in the range of $0.94 to $1.

For fiscal year 2013, the non-GAAP net income per diluted share expectation excludes the purchase accounting adjustment to fair value of approximately $300,000 for deferred revenue, forecasted share-based compensation expenses of approximately $9.5 million, estimated amortization of acquired intangible assets of approximately $7.3 million, compensation post-combination services of approximately $1.2 million, restructuring charges of approximately $1.1 million, business development charges of approximately $1.2 million, and the related impact of these adjustments on the provision for income taxes of $7.6 million.

That concludes our financial discussion this morning. Thank you for joining us, and we look forward to taking your questions.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Steve, go ahead please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Kelleher, Dougherty & Company.

Mark Kelleher - *Dougherty & Co. - Analyst*

Thanks for taking the questions. Could you talk about gross margins? That's a pretty impressive number there. Is that a trend we should see? What factors were helping gross margins there?

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. In gross margin this quarter, we had probably one unique -- a unique quarter, a one-time quarter due to the composition of the deals and the customer mix. We experienced about half of that percentage point being attributed to customer mix. The rest is inefficiencies that are related to our operations and volume. So, we consider that gross profit margin to be high for this quarter and will probably be towards the higher end of our long-term operating margin for the full year.

Mark Kelleher - *Dougherty & Co. - Analyst*

Okay. And on the telco demand side, where are we in the LTE rollout and the CapEx spending for that rollout? Are we just in the early stages or has that gone through? Where do you see that rolling out right now?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

I think it's somewhere in between. Right now, I think it started -- I mean the early trials were two, three years ago. We were far behind that, but now we see a lot of traction, people coming to us, including the (inaudible) providers they have selected somebody else two, three years ago. So I would say we are in -- I would say at the peak of the (technical difficulty) but somewhere in between, and at least one or two more years to go to hit the continued increased spending in this area.

Mark Kelleher - *Dougherty & Co. - Analyst*

Okay. And last question, were there any 10% customers in the quarter?

Jean Bua - *NetScout Systems Inc. - CFO*

Yes, there was one.

Mark Kelleher - *Dougherty & Co. - Analyst*

Okay, thanks.

Operator

Chad Bennett, Craig- Hallum.

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

Just a couple of questions. Service provider bookings looked really strong whether you look at them sequentially or year-over-year. I think they basically doubled either way. And I know you talked about MSOs and your traction there. I guess was this a unique quarter from a service provider bookings standpoint? Is this kind of dollar run rate for bookings and specifically in service provider sustainable going forward? Because clearly it jumped up quite a bit. I just wanted your take on that.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Yes, so, I think because of especially very large size and lumpiness of the deal, usually when you look at vertical distribution, it's better to look at it on a yearly basis. Obviously, we don't have the whole year now. So if you start looking quarter-by-quarter, then it looks very much good. So, I don't think you should expect that (inaudible) service provider. It's clear that service provider is doing much better than we expected and (inaudible) spending is down. But when you -- I think this Q will be much lesser when we finish the year, meaning that we will recover some of the (inaudible) stuff, pick up the enterprise. Service provider will continue but not at this rate. And so the long-term we still think a 40%, 60% split between service provider and rest of the enterprise.

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

Okay. And the 10% customer in the quarter, Jean, I assume that was in the service provider bucket.

Jean Bua - *NetScout Systems Inc. - CFO*

Yes it was.

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

And then just Jean or anybody, could you explain kind of the bookings-to-backlog metrics? Obviously, bookings were -- whether it was new bookings or overall bookings were up -- overall bookings were actually down year-over-year, and new bookings were up slightly year-over-year. I guess how do the bookings rhyme with the increase in backlog ending the quarter? Could you just teach me on that?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Just one thing to mention before Jean provides the details. One of the reasons we talked about the first half, we had a special program in place in Q1, and you might have noticed that it was significantly higher than the previous year. So some of the -- there was some pull-in from Q2, and that's partly the reason why the Q2 was sort of flat versus last year. But if you look at year-over-year for the first half, then you see a better trend. But I'll let Jean answer the rest of the question.

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. So, the way I think about it is when you look at first half over first half, new business bookings actually grew 15%. And then within that, there is a component that is the product new business bookings. That also grew about 15%.

Year-over-year, the backlog started almost at zero at the end of -- at the beginning of the year, and it grew to 14.5%. Right now, it's up to 19.5%. So, the new business bookings grew 15%. Backlog increased about $5 million in quarter-over-quarter. But it's really the revenue increase of almost 30% is more about how much we actually ship. And as we've talked in the past, the backlog itself is more a function of the timing of when some of the customers' orders come in, when the customer wants it, and our ability to reply to them within their shipping requirements.

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

Okay. Last one from me probably for Jean again. Deferred revenue is down about $10 million sequentially. I assume you just have some seasonal runoff in maintenance, but that seems like it's more than that.

Jean Bua - *NetScout Systems Inc. - CFO*

Service revenue related to renewals, you said?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Deferred revenue.

Jean Bua - *NetScout Systems Inc. - CFO*

Deferred revenue?

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

Deferred revs I think were down about $10 million sequentially. What drove that?

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. You are right. It's part of the -- you are correct. It is part of the seasonality. All of the renewal bookings were down a little bit this quarter to the tune of about $3 million to $4 million. There are still a few large renewal deals that are in negotiation that we expect will close probably in the early part of this third quarter.

Chad Bennett - *Craig-Hallum Capital Group - Analyst*

Okay, thanks guys.

Operator

Aaron Schwartz, Jefferies.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Good morning. I just had a question. Obviously, the service provider numbers were terrific here. As you look at your pipeline and sort of manage the business throughout the year and into next year, how do you manage sort of the pipeline of revenue for Fin Services and government? Obviously, you've got some spending constraints which are out of your hands. But certainly there's a lot of uncertainty there. It doesn't sound like the service provider will continue at the terrific clip it did here in Q2. Are you sort of lowering your assumptions for those other verticals for the remainder of the year? Do you have a different sort of programs to focus on that deal flow? Can you walk us through how we can get comfortable with the verticals outside of the service provider area?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

I think, basically, we don't look at or manage the pipeline by vertical. We make new guidance not based on the share of verticals but the total amount we want to do. So I think the way you need to get comfortable is our reiteration of guidance. That pipeline is strong. We can do -- we still feel good about the rest of the year despite the economic condition outside that while reiterating the guidance, in fact building the low end of the EPS guidance. So that's basically talked about our confidence in the pipeline and everything.

And as to the managing of the various verticals, they'll keep going up and down because of the large deals we have. You saw $13 million deals and just in one quarter, and so that -- we really don't manage that directly when there will be a separate VP for each of these areas, Service Provider and Enterprise. So we are overall looking at the pipeline for the entire business, including Service Provider, as a way to feel good about what we could do for the rest of the year.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Okay. And if we look at the backlog, obviously a strong member here. What is the vertical concentration within that number? Is that similar to how your bookings line up to where it's -- or is it sort of more heavy in service provider? Can you kind of walk through that a little bit?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Actually, we don't -- we don't talk about that because it's not meaningful. And it's all mixed all over the place. And again, like as you said, it keeps going up and down. I don't think it's a good representative of our business moving forward.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Okay.

Jean Bua - *NetScout Systems Inc. - CFO*

The detail you see in the new business bookings, that would've included any deals that did not have the opportunity to ship before the end of the quarter. So, the new business bookings vertical is representative of all the orders that actually came in for the quarter.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Okay. And just a clarification, but I thought the backlog was $11 million last quarter. It sounds like you just said it was $14 million and increased $5 million sequentially.

Jean Bua - *NetScout Systems Inc. - CFO*

You are correct. It was $11 million last quarter. It was $40 million at the end of Q2 FY '12 for comparisons about how the revenue grew versus new business bookings.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Okay. Understood. And then, on the OpEx, it was sort of odd to see the sales and marketing expense move lower by that degree on a sequential basis, given the metric here in the quarter. Can you sort of walk through that? And then presumably that would pick back up here in the back half, but can you sort of walk through why that came down so much on a sequential basis?

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. Basically, in sales and marketing, we had some initiatives that we did not execute or fund in Q2, and we expect we will do those in Q3 and Q4. Also, due to the customer mix and the incentive compensations that are related to the different customers or vertical deals we have, that had a decrease in incentive compensation also. So on operating margin, the operating margins, the one-time things that we don't think will continue in the future is almost about 3%.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Three points. Okay. The last question for me if I could. Can you just what through why the renewal bookings were down? That just seems to be a little out of step with the trends in your business.

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. The renewal bookings, as we have discussed in the past, include multi-year deals. So in FY '12 we had a few large customers that renewed for -- took advantage of their -- of deal negotiations, and they renewed for long periods of time. When we do that, they just go right into new business bookings. And that's why the service revenue is more smooth because of how we bring that in over the period.

New business bookings this quarter, the simple answer is that there were two deals that we are still in customer negotiations with. We do expect they will close sometime in Q3, and it's just more timing of when the deal negotiations finish.

Aaron Schwartz - *Jefferies & Co. - Analyst*

Understood. Thank you very much.

Operator

Scott Zeller, Needham & Company.

Scott Zeller - *Needham & Co. - Analyst*

Thank you. Good morning. Regarding the 10% customer, can you tell us if you took all of that in the quarter or did some of it get pushed out into backlog as well?

Jean Bua - *NetScout Systems Inc. - CFO*

That order came in probably in the middle of the quarter. And so we have the ability to fulfill the order and ship the entire order. So, the portion of that that is related to product revenue and that we actually shipped goes through product revenue. Some of the other components that are in there is maintenance and that will come through our maintenance service revenue line over time.

Scott Zeller - *Needham & Co. - Analyst*

Okay. And regarding the service provider business and LTE, Anil had talked about this earlier, could you talk about the visibility? I know there's a question about where we are in the lifecycle but could you talk about the actual structure of those deals and orders and if you have good visibility? Are these several quarters of consistent ordering, or is it one large order? Could you talk about the visibility that you have on those deals?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

I think when you -- yes, it's several quarters of good visibility. And -- but for a given customer, they are not going to order and they'll probably order once in a year. So until you order (inaudible) from a single vendor or be (inaudible) provider will be -- is very high. But usually one or two big ones we will have in each quarter, so we see good visibility definitely for this year's but even part of the first half of the next year in terms of the projects going on. And it's not just the US provider. We're talking about 15 or so Tier 1 provider across the world who are very invested in our solution and are investing in LTE. And we have several conferences coming up which we'll talk about in the next release -- the next earnings release of what's happening there in terms of the level of interest in our products.

Scott Zeller - *Needham & Co. - Analyst*

Okay. I'm not sure if I heard -- if I understood that well. So the -- it sounds as if there are several large customers that you have visibility to with several individual large orders, but the orders are not broken up over time. They come all at once. Is that --?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Yes. For a given customer, for one vendor, so it's like typically they will order and they'll order the next one after a year or so. That's what I was saying. So not all the tier ones are going to come in one specific quarter, which is (inaudible) that provides a good visibility. It's just timing is such that certain things will happen in one quarter, and it looks like a lot of things are lined up from an (inaudible) point of view for the next four quarters.

Scott Zeller - *Needham & Co. - Analyst*

And regarding the government vertical, which has been up and down for the Company over the past let's say 18 months, do you believe there is an issue with maybe concentration of large deals in certain agencies, or is it the sales execution problem? What would you say needs to be improved?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Right now, we don't see a sales execution problem. There were some (inaudible) we did about a year ago. I think it's largely and mostly on the defense side. We had some very large deals last year. If you're comparing with last year I think that's something different. But still I think we have jobs to recover even though we didn't see that project flush which we normally see in the first half. I think we should be seeing some more activity for the rest of the year.

Scott Zeller - *Needham & Co. - Analyst*

Thank you.

Operator

Matt Robison, Wunderlich Securities.

Matt Robison - *Wunderlich Securities Inc. - Analyst*

Good morning and congrats on the bookings against the tough comparison during the period last year.

Anil, can you talk about bookings in mobile compared to cable? It looks like you're penetrating cable somewhat incrementally. And can you give us a flavor of kind of the mix of -- in those two sectors? Just some background on my question. I've seen with some companies we get lumps of cable business where the kind of big but more mature networks that buy all at once and then deploy, they don't come back for another year sometimes where the mobile guys, their business can spread over multiple quarters because their networks are growing so much more on a percentage basis.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

We see the same thing. (inaudible) in terms of lumpiness and frequency of orders. There's not much different between mobile and the cable MSO. The MSO area is very small, I mean quite small compared to the mobile portion. We just started penetrating and talking about that. There are different competitors in that area. And we are having some success but compared to the overall mobile business, the MSO business is still quite small and it's dominated by a smaller number of customers right now than even though in mobile we have a lot of (inaudible) more than 10, maybe even 20. We are talking about much smaller numbers at this point in the cable MSO area.

Matt Robison - *Wunderlich Securities Inc. - Analyst*

Okay. And on this -- the backdrop for decline in service renewals, I know last year the second quarter was kind of a big catch-up in terms of bookings after a rough first quarter last year. And it looked like -- it sounds like there were some deals last year to kind of bring on some ground involving multiple year deals in the service renewal standpoint. So is that kind of a situation where you've got a tough comparison this year? I know you talked about some stuff that might've slipped into the current quarter. But can we look at it that way as well as you were trying to fill a hole in the backlog last year and this year you didn't have that kind of a circumstance?

Jean Bua - *NetScout Systems Inc. - CFO*

Just a slight correction. Service renewals or renewal bookings do not go into backlog. They go right into deferred revenue because when we get the order in, we have to take the portion in that pertains to that, so none of it goes into backlog. The backlog (multiple speakers)

Matt Robison - *Wunderlich Securities Inc. - Analyst*

No, I wasn't talking about -- I know your backlog is only product backlog, so --

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Jean Bua - *NetScout Systems Inc. - CFO*

Right.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

For revenue or backlog?

Matt Robison - *Wunderlich Securities Inc. - Analyst*

I'll just take the question off-line. Can you also -- can you give me CapEx and depreciation for the quarter and how many employees are working for you now?

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. CapEx for the quarter was about $3 million. Let me just make sure that's correct. Yes. CapEx for the quarter was about $2 million. So we had cash from operations of $20 million and then $18 million in free cash flow. For employees, headcount at this point, we have about around $950 million to $960 million.

Matt Robison - *Wunderlich Securities Inc. - Analyst*

So you added about 60 or 65 employees with the acquisition?

Jean Bua - *NetScout Systems Inc. - CFO*

With the acquisition of Accanto?

Matt Robison - *Wunderlich Securities Inc. - Analyst*

Yes.

Jean Bua - *NetScout Systems Inc. - CFO*

With that product technology acquisition, we only added about 30 to 35 people.

Matt Robison - *Wunderlich Securities Inc. - Analyst*

So 60, 65 overall sequentially, right?

Jean Bua - *NetScout Systems Inc. - CFO*

Let me get my headcount. Okay. So at the end of Q2, we had 941 employees in total. At the end of Q1, we had 895, so that is about, say, 35 to 40 people for Accanto and then the rest of them would be engineers, and some administrative and sales people and marketing people.

Matt Robison - *Wunderlich Securities Inc. - Analyst*

Okay, thanks.

Operator

Kevin Liu, B. Riley & Co.

Kevin Liu - *B. Riley & Co. - Analyst*

Good morning. Jean, I think you might have alluded to this earlier, but looking at the service revenue line, the strong sequential uptick, was that where kind of the unusual deal kicked in or is that a good number to use going forward?

Jean Bua - *NetScout Systems Inc. - CFO*

The service revenue line?

Kevin Liu - *B. Riley & Co. - Analyst*

Yes.

Jean Bua - *NetScout Systems Inc. - CFO*

That is probably a good number to use going forward.

Kevin Liu - *B. Riley & Co. - Analyst*

Then, well, in that case, maybe if you could give us a little more background on kind of the unique nature of the deal. Was it just the fact that it was a large service provider deal or was there something more we should be aware of in terms of how it impacted the numbers?

Jean Bua - *NetScout Systems Inc. - CFO*

The large 10% order?

Kevin Liu - *B. Riley & Co. - Analyst*

I'm not sure. You had referenced a unique deal in the quarter earlier. I'm just trying to pinpoint what sort of impact that might've had in terms of the reported numbers.

Jean Bua - *NetScout Systems Inc. - CFO*

Sure. So we had -- so, on operating margin, and I'll take a minute and walk through it so it's clear. On operating margin, we had about 3% increase, 28% operating margin, 3% one-time items that we do not think will recur. Those include just the unique customer mix and deal structures that happened in this particular quarter. And then on top of that we had efficiencies within the sales organization and some other items that we don't think will recur going forward. So that is about the 3% uptick in the operating margin this quarter.

In gross profit margin, the customer mix, about half of the efficiencies that we had in the growth projects -- in the gross profit line was due to the unique deal structures that we experienced in Q2.

Kevin Liu - *B. Riley & Co. - Analyst*

All right. And then with the 15% uptick in bookings through the first half this year, I know you guys said you had some more planned initiatives for the back half. What about as it relates to kind of hiring additional reps? Do you feel like you have enough coverage? Are there areas such as the sales engineering organization where you plan to ramp up more aggressively with headcount?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Yes, I think there are multiple things we are looking at, nothing specific in our accounting on sales for that to help in this year. So we might do some advanced hiring next quarter, but at this point, we don't have the mix of hiring. We are behind hiring right now, so that's what probably Jean was talking about.

Michael Szabados - *NetScout Systems Inc. - COO*

On the other hand, our new products from the acquisitions will come online and we think this is sales productivity. So that will drive some of the back-half number.

Kevin Liu - *B. Riley & Co. - Analyst*

Got it. And one last one on the government side. Anil, you just mentioned you still felt confident about some of these deals could still come through. I guess with the typical budget flush quarter behind us, why do you feel like these deal are in play? What gives you confidence that they ultimately get funded as we make our way through the back half of your fiscal year?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

What I was referring was that we will still be behind probably versus last year but not as much behind as it looks like right now. So I mean, we do decent business in the second half all of the time, and we think that will continue. Yes, budget flush is (inaudible) usually look very good. So we are disappointed there because of the condition, spending conditions. But what I was saying was we will recover some of the shortfall in the second half. There are -- there are new budgets and new spending, and so we are hoping that we will get some of those, especially on maybe some it on the civilian side. On the defense side is where we have the biggest shortfall versus last year.

Michael Szabados - *NetScout Systems Inc. - COO*

As we look at some of the specific deals that seem to have slipped into next quarter or beyond, and they are not subject to the budget flush, as Jean pointed out. The strategic projects are funded earlier in the cycle and -- but the spending is taking various lengths of time. So, we believe that, because we looked at the deals, that that's the case, that they've (inaudible) fell out.

Kevin Liu - *B. Riley & Co. - Analyst*

Got it. I appreciate the clarification. Thank you.

Operator

Patrick [Wu], Battle Road Research.

Patrick Wu - *Battle Road Research - Analyst*

Hi. Just a quick follow-up question to the headcount. Is that mostly in the Americas, or was that in other regions? I just want to get a better sense of that.

Jean Bua - *NetScout Systems Inc. - CFO*

So the headcount additions, the majority of the ones from Accanto clearly were in -- were based in Italy. The rest of the increases were on a global basis. So we have multiple centers of excellence where we hire engineers and then our salespeople are geographically dispersed also.

Patrick Wu - *Battle Road Research - Analyst*

Okay. The other question is regarding government. What is your sentiment moving forward? Obviously, possibly with maybe a little more clarity after the election, but I wanted to get your sense of what you guys are expecting closer to the end of the year and the beginning of next?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

I think, like I said, I think -- we think that [charts will] year-over-year percentagewise will be smaller than what we see in the first half. Beyond that, I think it's just we don't have any more clarity. I think things are going to be tough even after the election it takes time to recover. We have a fiscal year that ends in March, but we think there are some other projects which are independent of those conditions, and we will have some recovery in the second half versus last year, but it will be smaller than last year.

Patrick Wu - *Battle Road Research - Analyst*

That's all I have.

Operator

Sanjit Singh, Wedbush Securities.

Sanjit Singh - *Wedbush Securities - Analyst*

Thank you for taking my questions. Given some of the consolidation that's going on in the US carrier market, I wanted to get your view on how could that drive the timing of spending going forward?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Well, if you're talking about the two recent ones which are going on with T-Mobile in the US and SoftBank and Sprint, all of these are our customers. So I think, overall, (inaudible) some time, because of consolidation, these that are put on hold, but overall I think we will have a good advantage because we are already deployed on both sides, and so there will be champions on both sides for us going for [next out]. And someplace we have a split decision like when the acquirer acquiree was a competitor, then yes there will be some discussion about consolidating vendors. But right now we don't see that having any big impact on us in the next -- for the rest of the fiscal year or even into early next year. positive or negative.

Sanjit Singh - *Wedbush Securities - Analyst*

Great. I have two quick follow-ups. The big drops in Accounts Receivable this quarter, I just wanted to get some color as to why we saw that big of a decline sequentially. And then competitively, if you talk about the enterprise market and the service provider market, is there any changes going on in the competitive environment that you guys see?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

No change. I mentioned in my portion that we have a long-standing leadership in the enterprise. We announced a new USDM strategy, and towards the end of the year, we will be coming up with some new solutions and features that are going after a bigger market segment. So, I think the situation will be even stronger at that time, but there is generally no change. There are start-ups and some existing mid-tier players, but nothing changed. In fact maybe it's better for us, slightly better than versus last year.

On the service provider side, I think we are gaining more traction and we were in the top three and now we may be number one or top two now versus let's say a couple of years ago. So overall competitive situation is in our favor and that's what is helping us with these results also.

Jean Bua - *NetScout Systems Inc. - CFO*

So in answer to your question about Accounts Receivable going down sequentially, that mostly just has to do with the timing of when we actually get the orders and ship them. So, if you think about the backlog of $14 million that came out of Q1, and we would've shipped that in the beginning of the first week of Q2, and then the spacing and the timing of the other orders, it's just more a function of items coming in and we being able to collect them before the end of the quarter when we report. That's the reason for the decrease in Accounts Receivables sequentially.

Sanjit Singh - *Wedbush Securities - Analyst*

I appreciate that. That makes sense.

Operator

(Operator Instructions). Brian Murphy, Sidoti & Company.

Brian Murphy - *Sidoti & Co. - Analyst*

Thanks for taking my question. Just to follow up on the competitive environment, Anil, could you talk about if you're seeing any competitive response from incumbent vendors in the service provider space, maybe to become stronger on the IP side of the carrier business?

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Yes. They are getting stronger, but we are getting even more stronger. And so yes, they have -- we are not winning for the same reason as we were winning two years ago, but I can tell you for at least in a couple of cases two years ago we were behind in LTE versus those vendors even though we were the IP leader. And we are getting big orders from the Tier 1 providers who actually selected the incumbent. So, yes, competition is increasing. There are some new players now that we have wide solution from Accanto, and with a new category of players, their new players on the MSO side which are like different incumbents. We are the only ones who are across the board, so that does sometime creates more competition for us but we had a wider audience also.

Brian Murphy - *Sidoti & Co. - Analyst*

Okay, thank you.

Operator

I'm showing there are no further questions at this time. I'll turn it back over to NetScout for any closing comments.

Anil Singhal - *NetScout Systems Inc. - President, CEO*

Okay, thank you for your time today and your questions. We'll talk to you again in January. Thanks.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.