NASDAQ:NTCT Q2 2025 Earnings Call Transcript

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Operator | Conference Operator:

Ladies and gentlemen, thank you for standing by, and welcome to NETSCOUT's second quarter fiscal year 2025 financial results conference call. At this time, all parties are in a listen-only mode, and tell the question and answer portion of the call. As a reminder, this call is being recorded. Tony Piazza, NETSCOUT's Deputy CFO, and his colleagues at NETSCOUT are on the line with us today. If you require operator assistance at any time, please press star zero. I would now like to turn the call over to Tony Piazza to begin the company's prepared remarks.

Tony Piazza | Deputy Chief Financial Officer:

Thank you, Operator, and good morning, everyone. Welcome to NETSCOUT's second quarter fiscal year 2025 conference call for the period ended September 30th, 2024. Joining me today are Anil Sankal, NETSCOUT's President and Chief Executive Officer, Michael Zabados, NETSCOUT's Chief Operating Officer, and Jean Bua, NETSCOUT's Executive Vice President and Chief Financial Officer. There's 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. Moving on to slide number three, 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. Now, let's turn to slide number four, 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 based 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 the 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 Sankal | President and Chief Executive Officer:

Anil. Thank you, Tony, and good morning, everyone. Welcome and thank you all for joining us today. We delivered Q2 fiscal year 2025 revenue and earning results in line with our expectations as we continue to position NETSCORE to win in the market. We remain confident that our differentiated solutions are well positioned to address our customer cybersecurity and service assurance needs well into the future. During the quarter, we released several products and product enhancement aligned with key technology trends that help address our customer cybersecurity and service assurance needs, including our AI-ready smart data solutions. We also had a strong turnout and interest in our recent annual Engage Technology and User Summit that we attribute to our customer 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 the opportunity and navigate the challenges of the current market environment. Let's turn to slide number six for a brief recap of our non-GAAP financial results for the second quarter and first half of our fiscal year 2025. For the second quarter, Revenue was approximately $191 million, down approximately 3% compared to the prior year period. The comparison was impacted by two items that benefited the prior year period. Approximately $11 million of backlog-related revenue and approximately $3 million for the now-devastated test optimization business. Normalizing for those, Q2 revenue would have grown at a mid-single-digit percentage. The diluted earnings per share was 47 for the second quarter, which is down approximately 23 cents or 14 cents from the prior year. As we previously noted, this includes an approximately 15 cents had been from the reversal of incentive-based related expenses that benefited last year's Q2. Normalizing for this Q2 earnings would have been slightly higher year over year, even after absorbing the $0.02 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, down approximately 10% 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 this factor, our first half revenue would have grown low single digits year over year due to solid order flow growth. The corresponding diluted earning per share for the first half of 75 cents was a decrease of approximately 18 cents 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 again on a foreign investment help to offset the revenue headwind impacts. Now let's move to slide number seven for some further perspective on business and market insights. Starting with our service assurance offerings, revenue for the first half of fiscal year 2025 was down approximately 13% year over year. That decline was largely attributed 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 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 be an additional business by leveraging our value proposition of extending visibility to the edges of the network. Additionally, as customers advance their AI initiative, 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. Moving to our cybersecurity offering, revenue in the second quarter increased approximately 3% and was down approximately 4 cents for the first half, primarily due to the backlog-related headwind. Cybersecurity continued to represent a strong growth opportunity for NETSCOUT as customers prioritized 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 activist 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 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 eight to review our outlook. Looking ahead, we are reaffirming our full 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 continue 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 of annualized cost reduction, a portion of which will be recognized during fiscal year 2025. Long-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.

Michael Zabados | Chief Operating Officer:

Thank you, Anil, and good morning, everyone. Slide 10 outlines the areas I will be covering today, starting with Q2 customer win highlights. This quarter, I will begin by focusing on a high single-digit, eight-figure combination of orders from a leading global financial institution that spans both our service assurance and cybersecurity product lines. This has been a longstanding 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 insecurity, to assure and secure their network. We were awarded this additional business relationship. Turning to our growth go-to-market activities now. As I stated, we recently released our first half 2024 DDoS threat intelligence report. The report provides a significant insight into the evolving cybersecurity landscape, leveraging our visibility into nearly half of all internet traffic. Additionally, since the last earnings call, we have announced several products that have This includes the release of our Omnis AI Insights solution to deliver high-quality, actionable, AI-ready streaming smart data based on deep packet inspection technology to feed our customers AI initiatives and enable critical insights and outcomes. We also announced an update of our advanced, scalable deep packet inspection-based Omnis cybersecurity network detection and response for NDR platform. which now has additional behavior analytics to enable earlier detection of advanced threats. Finally, we recently hosted our NUI Engage Technology and User Summit in Arlington, Texas. 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 data set 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 this 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.

Jean Bua | Executive Vice President and Chief Financial Officer:

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 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, down 2.9%. As Anil shared, our Q2 fiscal year 2025 revenue would have grown at a mid-single-digit percentage when normalizing for the $11 million in backlog usage and $3 million from the disposition of our test optimization business that took place last year. Product revenue of $81 million was up 0.6% year over year. Service revenue was $110.1 million, a decrease of 5.3%, 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% in the second quarter, down 0.6 percentage points. Quarterly operating expenses increased 5.2% in comparison to the prior fiscal year, which benefited from the reversal of incentive-related expenses. Normalizing for this, operating expenses would have declined in single digits primarily attributable to cost management initiatives, including the voluntary separation program. We reported an operating profit margin of 23.1% in Q2 fiscal year 2025, compared with 28% in the same quarter last year. Diluted earnings per share was 47 cents, which included an unrealized loss on a foreign investment of approximately two cents. This was down 23% 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. 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 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%. while our cybersecurity revenue decreased by 3.9%. During the same period, our service assurance product line accounted for approximately 65% of our total revenue, while our cybersecurity product line accounted for the remaining 35%. 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%. During the same period, our enterprise customer vertical accounted for approximately 60% of our total revenue, while our service provider customer vertical accounted for the remaining 40%. Turning to slide 14, this shows our geographic revenue mix. For the first half of fiscal year 2025, 58% of our revenue was derived from the United States, with the remaining 42% 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 details certain balance sheet and free cash flow items. We ended the second quarter with $401.9 million in cash, cash equivalents, short and long-term marketable securities, and investment. representing a decrease of $22.3 million since the end of fiscal year 2024. Free cash flow for the quarter was a use of $5.8 million. During the second quarter of fiscal year 2025, we repurchased approximately 14,000 shares of our common stock for approximately $257,000, or an average price of $18 per share. We currently have capacity in our share repurchase authorization and subject to market conditions and tend 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 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 to $600 million 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, representing a decrease of $73.5 million since March 31st, 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 metrics in the second quarter of this fiscal year was due to the timing and composition of bookings. Let's move to slide 16 for commentary on Iowa Outlook. I will focus my review on our non-GAAP targets for fiscal year 2025. 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 revenues in the range of $800 million to $830 million. Additionally, we continue to anticipate non-GAAP diluted earnings per share within the range of $2.00 to $2.30 with the midpoint consistent year over year. The full year effective tax rate is expected to be approximately 20%. 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 the year-to-date unrealized gains, 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 a gap restructuring charge in the first half of fiscal year 2025 attributable to one-time separation payments of $19 million, $2.4 million of which was in the second quarter. We expect to record an additional restructuring charge of approximately $6.6 million in the third quarter of fiscal year 2025, primarily for severance costs associated with the remaining implementation of the current BSP. We expect that these actions will generate annual 1 rate savings of approximately 25M dollars of which approximately 19M 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% in the first half of fiscal year and 55% in the second half of the fiscal year. We expect the remaining 55% of the full fiscal year's revenue to be essentially 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.

Operator | Conference Operator:

Thank you. And at this time, if you would like to ask a question, please press star 1 on your telephone keypad. If you wish to remove yourself from the queue, press star 2. We do ask in the interest of time that you limit yourself to one question and one follow-up. And we will take our first question from Matthew Hedberg with RBC Capital Markets. Please go ahead.

Mike Richards | Analyst:

Hey, good morning. This is Mike Richards on for Matt. Thanks for taking the question. Maybe just more broadly to start, are you guys seeing things stabilize in the environment? And then given that you expect an even split between Q3 and Q4 revenue, which usually shows a seasonally strong Q3. Do you think you could get some boost from a December budget flush this year that you're maybe not factoring in? Thanks.

Anil Sankal | President and Chief Executive Officer:

Yeah, I think that's why we have a guidance range to account for those kinds of upsides. Usually, we benefit from the budget flush because we work with very big companies, large carriers, and that's why you often the Q3 is actually better than Q4 in terms of booking. Yeah, we are looking to that and we are working on several opportunities.

Mike Richards | Analyst:

Got it. And then maybe is there anything, you know, notable to call out in cybersecurity in terms of, you know, what's driving growth and then maybe how that's tracking against your internal expectations and getting to that double-digit growth that you guys are aiming towards?

Anil Sankal | President and Chief Executive Officer:

Yeah, so we have made a slight pivot about six months ago in terms of our positioning to cover some of the gaps in cybersecurity solutions in the market, which is more around the analytics part, which we have some of the best technology in the DPI area. So that's going very well. Traction is a little slow, but we are looking So over the next six to 12 months, I think we're going to see this attached to some of our customers. And we have also come up with some interesting ideas on how we can position our OCI or Omnis Cyber Intelligence solution in the DDoS space, which was not in the plans last year.

Mike Richards | Analyst:

Great. Thanks, guys.

Operator | Conference Operator:

Thank you. And we will take our next question from Kevin Liu with K. Liu and Company. Please go ahead.

Kevin Liu | Analyst:

Hey, good morning, guys. Nice quarter here. Maybe just to start off with, you know, Verizon has started talking about moving towards standalone 5G in the near future. I'm wondering if you can talk through some of the puts and takes on how that either, you know, increases your opportunity as they do things like network slicing versus any risk you might see if they start to, you know, deprecate some of the more legacy 4G networks.

Anil Sankal | President and Chief Executive Officer:

Well, there is continued to be, Kevin, a consolidation in the market, both in Europe and this, so it does affect some of our business. But overall, I think the vendors are introducing slicing this year. We are announcing a new release. I don't see a big potential in the short term on private 5G or standalone, but slicing is both a revenue opportunity for our customer as well as for us because slicing is the option. optional module in our solution, which doesn't require new hardware upgrade, but this software solution. So yeah, we are looking for initial two or three customers in the US very interested in leveraging that functionality.

Kevin Liu | Analyst:

Got it. And then also just on the carrier front, there seems to be more talks on their part about this convergence of mobile and fiber broadband. I'm wondering if you have solutions to address the latter piece of that, or if there's anything in the pipeline that you could do in order to help carriers as they move down that strategy?

Anil Sankal | President and Chief Executive Officer:

Yeah, so there are two kinds of carriers. People who are monitoring user plan, and those people will obviously drive more business with us as fixed wireless initiatives take over in the US and elsewhere. And we are counting on that for next year. For people who are not monitoring user plane, they are largely not impacted from a revenue point of view for us. But our top five or six big customers are all very interested and we think that there'll be uptake in the dramatic uptake in the fixed wireless traffic. And also the R pools for those are much better than the mobility. So because of that, I think there'll be potential investment on NETSERC.

Kevin Liu | Analyst:

Great. And if I could just ask one last one, any update on your AIOps strategy as it relates to how much contribution you expect from some of the leading partners that you talked about versus what you guys might be focused on directly?

Anil Sankal | President and Chief Executive Officer:

Yeah, this is very early. We have We've seen a lot of interest, a lot of discussions are going on with the customer and partners, but we don't expect much impact from that this fiscal year from AIOps.

Kevin Liu | Analyst:

Thanks for taking the question.

Operator | Conference Operator:

Thank you. And it appears that there are no further questions at this time. I will now turn the program back to Tony Piazza.

Tony Piazza | Deputy Chief Financial Officer:

Thank you, operator. That concludes our financial results call for today. Thank you for joining us and enjoy the rest of the day.

Operator | Conference Operator:

Thank you. This does conclude today's presentation. Thank you for your participation. You may disconnect at any time.