NASDAQ:NTCT Q3 2025 Earnings Call Transcript

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Operator | Moderator:

Please stand by. Your program is about to begin. Ladies and gentlemen, thank you for standing by. And welcome to NETSCOUT's third 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 call 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 third quarter fiscal year 2025 conference call for the period ended December 31st, 2024. Joining me today are Anil Singhal, NETSCOUT's President and Chief Executive Officer, Michael Sabados, NETSCOUT's Chief Operating Officer, and Gene 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. 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 facts. 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. NESCAP assumes no obligation to update any forward-looking information except as required by law. Let's now 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 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 will be applicable if 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 Singhal | President and Chief Executive Officer:

Anil? Thank you, Tony, and good morning, everyone. Welcome and thank you all for joining us today. We delivered Q3 fiscal year 2025 revenue and earnings results that exceeded our expectations with strong performance across both our cybersecurity and service assurance product lines. These results reflect solid execution and the strength of our differentiated solution in addressing the evolving needs of our customers. It's important to note that certain customer orders initially anticipated in the fourth quarter were instead received in the third quarter as customers leveraged the calendar year end budgets. While the timing accelerated certain revenues into Q3, The contribution of these early orders have reinforced our confidence in achieving our full fiscal year 2025 goals and expectations. As we capitalize on opportunity and address the complexity of today's market, we remain confident in our ability to deliver value and meet our customers' cybersecurity and service assurance needs now and into the future. Let's turn to slide number six for a brief recap of our non-GAAP financial results for the third quarter, and first nine months of fiscal year 2025. For the third quarter, revenue was approximately $252 million, up approximately 16% compared to the prior year period. This performance was driven by strong results in both our cybersecurity and service assurance product lines. Diluted earnings per share was $0.94 for the third quarter, which was up approximately 29% from previous year. For the first nine months of the fiscal year 2025, or the period ended December 31, 2024, revenue was approximately $618 million, down approximately 1% year-over-year, reflecting the impact of previously disclosed headwinds. This included unusually high levels of backlog-related revenue and the test optimization business diversions that both benefited the prior year's results and affected the comparisons. The corresponding diluted earnings per share for the first nine months of the fiscal year 2025 was $1.70, an increase of approximately 3% year over year. Now let's move to slide number seven for some further perspective on business and market insights. Starting with our service assurance offering, revenue in the third quarter increased approximately 9%, driven by the acceleration of a large service provider order previously expected in our fourth quarter. For the first nine months of the fiscal year 2025, service assurance revenue was down approximately 5%, primarily due to the previously discussed backlog and deficit-related headwinds. In the service provider customer vertical of our service assurance business, carriers continue to invest in 5G initiatives, at a measured pace as they manage investments against monetization opportunities. On the enterprise front, customers are seeking solutions capable of better advancing their digital transformations and extending visibility to the edges of their network. Our new edge solutions are gaining traction in this area. Moving to our cybersecurity offerings, revenue in the third quarter increased approximately 29%, and increased approximately 7% for the first nine months for the fiscal year 2025. Cybersecurity continues to represent a solid growth opportunity for NetScout, as customers prioritize spending to protect themselves from the expanding cyber threat landscape, not only related to the data center, but at the edge of their networks as well. Accordingly, we continue to enhance our cybersecurity offering with solutions like Adaptive DDoS. For example, we recently announced that our Arbor Edge Defense and Arbor Enterprise Manager products are now updated with artificial intelligence and machine learning technology as part of our adaptive DDoS protection solution to combat AI-enabled DDoS threats. Michael will provide more insight regarding customers in our operating area during remarks. Now let's move to slide number eight to review our outlook. Given our strong performance in the third quarter, along with the acceleration of certain orders, we now have increased visibility and confidence in achieving our full fiscal year 2025 financial objectives. As such, with one quarter remaining in the fiscal year, we are updating our fiscal year 2025 outlook, narrowing the ranges while maintaining the midpoint from the previous guidance for revenue and non-GAAP net income per share. Jean will provide additional color in our outlook in her remarks. Looking ahead, we remain focused on executing effectively as we position the company for the fiscal year 2026 and beyond. At the same time, we continue to leverage the strength of our Visibility Without Borders platform to enable customers to address the performance, availability, and security challenges inherent into this complex digital landscape. We look forward to sharing our progress with everyone at the conclusion of our fiscal year. With that, I'll turn the call over to Michael.

Michael Sabados | Chief Operating Officer:

Thank you, Anil, and good morning, everyone. Slide 10 outlines the area I will be covering today, starting with Q3 customer win highlights. Starting with our service assurance offerings, one notable win this quarter in the service providers customer segment, was a high-tech, was a high-team, eight-figure order from a long-standing Tier 1 North American carrier customer for 5G-related solutions as they further expand their network capacity. As Anil pointed out, this order was received earlier than anticipated in our fiscal year. We remain focused on supporting our carrier customers as they further advance their 5G network solutions. In the enterprise customer vertical of our services transfering, We are seeing a growing need for network visibility at the edges of our customers' networks. One notable deal was a multi-year enterprise license agreement order, ELA it's called, with an aggregate value in the mid-teen eight-figure range with additional amount in the low seven-figure range. This win was from a leading domestic healthcare provider customer who had grown through acquisition and attempted with limited success to address user experience challenges at its remote clinics and physician offices using competitor and homegrown solutions. The customer plans to roll out our visibility solutions to thousands of locations over multiple years and phases during the ELA period. Shifting to our cybersecurity offering, we want a mid-seven-figure order from a longstanding North American cable operator This customer purchased our new onboard distributed threat mitigation system or DTMS solution that allows them to dynamically allocate their DDoS mitigation capacity to protect the emerging new edges of the network. In terms of go-to-market activities, we continue to actively promote our offerings to both existing and prospective customers at key industry events. In early December, we participated in the AWS reInvent Conference in Las Vegas, where we demonstrated how NETSCOUT's visibility, resiliency, and security solutions, combined with the value of our smart data, unlock the power of our exceptional user experience in the AWS cloud ecosystem. We partnered with Palo Alto Networks to demonstrate the power of NETSCOUT's smart data to take threat detection and respond to the next level to protect and secure multi-cloud and hybrid cloud environments. We plan to be an active participant in the Mobile World Congress in Barcelona in early March, where we will present our latest innovations for enhancing our smart data to accelerate service provider efforts in the 5G, NetOps, AIOps, and mobile network security. At the same time, we will have a NETSCOUT team at the 2025 IMSS, HIMSS Global Conference in Las Vegas, where we will demonstrate our NETSCOUT's visibility and security solutions of protection of performance and availability of essential healthcare networks, applications, and services for some of the world's leading healthcare organizations. And finally, in late April, we will be attending the RSA Conference 2025 in San Francisco, where we will showcase how NETSCOT's visibility with our borders platform combines our engineers' performance management, RBO DDoS protection, and omnis network security solutions to provide end-to-end security, performance, and availability for the world's most powerful digital ecosystem. That concludes my remarks. Thank you, everyone. I will now turn the call over to Gene.

Gene Bua | Executive Vice President and Chief Financial Officer:

Thank you, Michael, and good morning, everyone. I will review key metrics for our third quarter and first nine months 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 third quarter and first nine months of fiscal year 2025. Focusing on our quarterly performance, total revenue for the third quarter of fiscal year 2025 was $252 million, up 15.6%. Product revenue was $128.2 million. an increase of 33.8%, while service revenue was $123.8 million, an increase of 1.3%. Gross profit margin was 82.8% in the third quarter, up one percentage point. Quarterly operating expenses increased 3.2%. Accordingly, we reported an operating profit margin of 35.6%, compared with 29% in the same quarter last year. Diluted earnings per share was $0.94, which included an unrealized loss on a foreign investment of approximately $0.07. This was up 28.8% from $0.73 in the same quarter last year. Turning to slide 13, I will review key revenue trends by product lines and customer Please note that all comparisons here are on a year-over-year basis consistent with our other remarks. For the first nine months of fiscal year 2025, our service assurance revenue decreased by 5.5%, while our cybersecurity revenues grew by 7.4%. As a reminder, we entered the prior fiscal year with approximately $50 million of backlog, which we did not get the benefit of this fiscal year. 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 nine months of fiscal year 2025, our enterprise customer vertical revenue grew 3.7%. while our service provider customer vertical revenue decreased 7.2%. During the same period, our enterprise customer vertical accounted for approximately 57% of our total revenue, while our service provider customer vertical accounted for the remaining 43%. Turning to slide 14, this shows our geographic revenue mix. For the first nine months of fiscal year 2025, 59% of our revenue was derived from the United States, with the remaining 41% provided by international markets. Also, one customer represented 10% or more of our total revenue in the third quarter, as well as for the first nine months of fiscal year 2025. Slide 15 details certain balance sheet and free cash flow items. We ended the third quarter with $427.9 million in cash, cash equivalents, short and long-term marketable securities and investments, representing an increase of $3.8 million since the end of fiscal year 2024. Free cash flow for the quarter was $39.6 million. We currently have capacity in our share repurchase authorization and subject to market conditions, intend to be active in the market during fiscal year 2025. From a debt perspective, we entered the third quarter of fiscal year 2025 with $75 million outstanding on our $600 million revolving credit facility, which expires in October 2029. In the fourth quarter of fiscal year 2025, we intend to fully repay the outstanding $75 million of debt. Briefly recap other balance sheet items. Accounts receivable net was $214.6 million, representing an increase of $22.5 million since March 31st, 2024. The DSO metric at the end of the third quarter of fiscal year 2025 was 75 days, versus 90 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 third quarter of this fiscal year was due to the timing and composition of bookings. 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. As Annelle noted earlier, with one quarter remaining in the fiscal year, we are narrowing our fiscal year 2025 outlook ranges while maintaining the revenue and non-GAAP diluted earnings per share midpoints that were presented in October 2024 during our second quarter earnings call for fiscal year 2025. For fiscal year 2025, we now anticipate revenue in the range of $810 million to $820 million Additionally, we now anticipate non-GAAP diluted earnings per share within the range of $2.15 to $2.25. 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 year-to-date share repurchase activity, but does not assume any further repurchase activity. That concludes my formal review of our financial results. Thank you, and I'll now turn the call over to the operator for questions.

Operator | Moderator:

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 | Representative for Matt Hedberg, RBC Capital Markets:

Hey, good morning, guys. This is Mike Richards on for Matt. Thanks for taking the questions. Sure. Yeah, it was great to see the strength in the quarter. You know, I think coming into the quarter, we kind of expected a muted budget flush from service provider. And, you know, you called out that high team's ace figure pulling. But it kind of looks like guidance implies, you know, another 10 million or so pulled in. So, you know, maybe you could provide us some more detail on, you know, what changed here? Is there a bigger shift in trends? And, you know, what service providers are looking to spend on? And then just like a broader update on your views in the IT spending environment.

Anil Singhal | President and Chief Executive Officer:

Yeah, I think the overall business has stabilized, but I think on the service provider side, it was many of the service provider customers, their fiscal year starts in January. And so we always have this battle sometime. Sometime we get the our Q4 business in Q3. So that big order we're talking about was basically think of it instead of getting X plus Y into quarter, we got both X plus Y. And so that's basically no big strategic reason. It's just that they had more confidence and they had more budget available this year. And that was mainly the reason. But there is a lot of activity in the Spend is not backed by spend right now, but there's a lot of activity in the 5G cloud area and slicing and other things, which NETSCOT has invested a lot, but has not hit the revenue stream right now. So we expect that will be the reason for spend in the next fiscal year.

Mike Richards | Representative for Matt Hedberg, RBC Capital Markets:

Great. And then... You guys seemed excited about an emerging opportunity in fixed wireless, so I was just wondering if you could provide an update there and maybe where we are in that journey.

Anil Singhal | President and Chief Executive Officer:

I think it's still early. We have evaluation going on with three or four customers right now, and our solution is ready, but the amount of money spent on this could be huge because of the amount of traffic. We are looking at some other creative way of looking at VIP traffic as a way to manage the situation. And so at this point, we don't have any success to report in that area, but they continue to be interested in the all top three or four customers of NETSCOUT.

Mike Richards | Representative for Matt Hedberg, RBC Capital Markets:

Awesome. Thanks, guys, and congrats again. Thank you.

Operator | Moderator:

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

Kevin Liu | Analyst at K. Liu and Company:

Hey, good morning, guys, and congrats as well on the strong performance here in the third quarter. Maybe to go back to the service provider side of things, it certainly sounds like budgets have stabilized and we might be at the start of kind of a new upswing in spending there. As you look out for the rest of this calendar year, is that something that you guys are seeing and hearing from your customers as well? And then maybe just touch on You know, some of these newer areas are spending on, in particular, this large order. Is that more tied to some of the legacy projects they've had going on, or are you actually seeing them invest in kind of new areas of monetization?

Anil Singhal | President and Chief Executive Officer:

Yeah, so I look at, Kevin, is that I think business has sort of stabilized, and you will see some swings because of large order from quarter to quarter. But next year, I mean, we are counting on our existing customers, but not necessarily growing in the traditional way mobile service assurance area, but there are opportunities in cybersecurity. We have a product in the AI area, which we have talked about in the previous calls. And as earlier question indicated, there could be a span in the fixed wireless area and slicing and other areas of 5G. There is some interest in utilities on the private 5G area. So we look at Our investment in the service provider area in 4G and 5G, not necessarily delivering in the growth in the traditional area, but in other areas, as I just talked about.

Kevin Liu | Analyst at K. Liu and Company:

And maybe just on your cybersecurity products, you know, very strong growth here in the third quarter. How did that split out between kind of enterprise versus service provider for Q3 specifically? And then as you look at your pipelines moving forward, Do you think you can continue to accelerate, you know, your overall growth rate relative to what you've shown over the past nine months?

Anil Singhal | President and Chief Executive Officer:

Yeah, so Tony is checking us. I don't have the breakdown right now on this, but overall, go ahead, Jay.

Gene Bua | Executive Vice President and Chief Financial Officer:

So, Kevin, your question is in service provider, in security service provider and enterprise for the quarter, how do they grow? On quarter-over-quarter basis, service provider grew in close to the mid-20s. and enterprise grew close to the mid-30s percentage-wise.

Kevin Liu | Analyst at K. Liu and Company:

Sorry, I was going to just have you elaborate on that and kind of the future outlook there, whether you can sustain growth rates anywhere near these levels or how you're thinking about that.

Anil Singhal | President and Chief Executive Officer:

Well, that was the quarterly one. As you know, the year-to-date is in the 7% or so range overall aggregates. But we hope that we can do much better in this area. A lot of the growth is in the DDoS area. As you know, we announced a new product in this area, Omni Cybersecurity. And there's a lot of interest. We have a lot of valuation going on. But that is not a big contributor to this year's growth. So next year, we expect growth from that area. And as we share our guidance in the next quarter, for the next fiscal year, I will highlight that.

Kevin Liu | Analyst at K. Liu and Company:

All right. Sounds great. Really appreciate you taking the question.

Anil Singhal | President and Chief Executive Officer:

Thank you.

Operator | Moderator:

Thank you. Thank you. And it appears that we have no further questions at this time. I will now turn the program back to Tony for any additional or closing remarks.

Tony Piazza | Deputy Chief Financial Officer:

Excellent. Thank you, operator. This will conclude our call for today. Thank you for joining us and enjoy the rest of the day.

Operator | Moderator:

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