NASDAQ:NTCT Q2 2026 Earnings Call Transcript

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Operator | Conference Operator:

Gentlemen, thank you for standing by, and welcome to NETSCOUT's second quarter fiscal year 2026 financial results conference call. At this time, all parties are in a listen-only mode until the question and answer portion of the call. As a reminder, this call is being recorded. Scott Dressel, AVP Corporate Finance, 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 Scott Dressel to begin the company's prepared remarks.

Scott Dressel | AVP Corporate Finance:

Thank you, operator, and good morning, everyone. Welcome to NETSCOUT's second quarter fiscal year 2026 conference call for the period ended September 30th, 2025. Joining me today are Anil Singhal, NETSCOUT's president and chief executive officer, and Tony Piazza, 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.netscap.com, including the IR landing page under financial results, the webcast itself, and under financial information on the quarterly results page. As discussed in detail on slide number three, Today's conference call will include certain forward-looking statements about NETSCOT's views on expected results of future performance and business strategy. These statements speak only as of today's date and involve risks, uncertainties, and assumptions that may cause actual results to differ materially, including but not limited to those described in the company's most recent annual report on Form 10-K and subsequent trialings with the Securities and Exchange Commission. As discussed in detail on slide number four, today's conference call will also include discussion of certain non-GAAP financial measures that the company believes to be useful to investors. While this slide presentation includes both GAAP and non-GAAP results, other than the revenue and balance sheet information, we will focus our discussion on non-GAAP financial information. should not be considered in isolation from or as a substitute for financial information prepared in accordance with GAAP. Reconciliations of all non-GAAP metrics to the nearest GAAP measures are provided in the appendix of the slide presentation in today's financial results 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:

Thank you, Scott, and good morning, everyone. Thank you for joining us today. We delivered another solid quarter in Q2, driven by revenue growth from both our cybersecurity and service assurance product lines, as we continue to advance our strategic initiatives, including AI-driven product innovation. Our strong top and bottom line performance also benefited from the acceleration of some orders originally anticipated in the second half of the fiscal year. Given our strong first half performance, we are raising our revenue and earning per share outlook, which Tony will detail in this financial review. Let's turn to slide number six for a brief recap of our financial results for the second quarter and the first half of fiscal year 2026. Revenue was approximately $219 million, representing an increase of nearly 15% year-over-year driven by solid growth in both our cybersecurity and service assurance areas of our business, along with the acceleration of certain orders originally anticipated to occur in our second half. We expanded both our gross and operating margins during the quarter and delivered diluted earnings per share of $0.62, an increase of approximately 32% year

over year. For the first half of the fiscal year, or the six months ended September 30th, revenue was approximately $406 million, an increase in approximately 11% year-over-year, which benefits from a solid growth in both cybersecurity and service assurance area for business, along with the previously mentioned acceleration of certain orders. We expanded both our gross and operating margins during the first half of the fiscal year and delivered diluted earnings per share of $0.95, an increase of approximately 27% year-over-year. Now let's turn to slide number seven for some perspective in our business and some market insights. Starting with our service assurance offering, revenue in first half of the fiscal year increased approximately 10% year over year, driven by growth from both our enterprise and service provider customer verticals. We achieved solid growth across most of our major enterprise sectors, with the federal government being particularly strong in the first half. This sector benefited from both underlying demand and the acceleration of certain orders expected in the second half. In the service provider area, growth was largely attributable to the timing of maintenance renewals, including back maintenance that process in Q2 versus Q3 in the prior year. Our enterprise customers are continuing to invest in digital transformation initiatives related to enhanced visibility, observability, and AIOps initiatives. Accordingly, we are driving intelligence into observability and AIOps to feed the need for actionable telemetry derived from wire data and to leverage the unmatched power of our scalable DPI and metadata technology. We also recently launched our Omnis ClearSight sensor for Kubernetes which provides comprehensive observability within the complex cloud environment. It delivers deep, actionable, and real-time insights into the system performance, health, and cost drivers. The solution reflects our vision of visibility without borders and is specifically designed to support dynamic and distributed architectures, which are challenging environments to monitor due to their encrypted nature. On the service provider side, Domestic and international carriers continue to align their investments with clearly defined 5G monetization opportunities such as fixed wireless access and private 5G. Although the service provider space remains challenging, we remain optimistic that NETSCOUT can capture further opportunities by delivering differentiated value as we continue to navigate the current environment. For example, we recently announced solutions to support cable providers and multiple service operators, or MSOs, with Omnis AI Insights, which generates a high-fidelity curated data set to provide real-time network visibility, ensuring a high-quality user experience for video streaming and over-the-top services to help MSOs deliver high-quality user experiences more cost-effectively. Moving to our cybersecurity offering, revenue in the first half increased nearly 13% year-over-year, driven by growth in both our enterprise and service wider customer verticals. Organizations continue to prioritize this area as they seek to protect themselves against an increasingly complex and expanding cyber threat landscape. In late August, we released our latest research detailing the evolving distributed denial of service landscape and how such attacks can destabilize critical infrastructure. Just in the first half of this year, activist groups launched hundreds of coordinated attacks each month targeting communication, transportation, energy, and defense systems. What is particularly concerning is how DDOTS for Hired Services has made sophisticated attack tools available to virtually anyone. These attacks now use AI-enhanced automation, multi-vector approaches, and carpet bombing techniques that overwhelm traditional defenses. Botnets are compromising tens of thousands of IoT devices, servers, and routers to deliver sustained attacks that cause real disruption and are creating an unprecedented level of cyber risk for organizations and service provider networks. NETSCORE solutions are designed to mitigate this risk by leveraging our unparalleled visibility into global attack trends. Moving on to customer wins. Our solution continues to gain traction with customers seeking to enhance their visibility, observability, and cybersecurity capabilities, leading to combined solution wins across our service assurance and cybersecurity offerings within customer orders. Highlights for the second quarter include an enterprise deal with multiple orders totaling an amount in the eight-figure range, part of which we received earlier than anticipated, related to a U.S. government agency that we have been a loyal and long-standing user of our solution. These orders are follow-on orders from orders received last quarter and consist of both service-assured and cybersecurity solutions, including our new AI and cyber intelligence products. This user values our solution for the smart data we provide, which they are leveraging to enhance their user experiences and support AI-driven operations and initiatives as they modernize their technology environment. Additionally, in the service provider area, we won a low seven-figure deal with a major U.S. telecommunication company that's another loyal and longstanding customer. This deal included our adaptive DDoS and distributed TMS cybersecurity solutions that the customer opted to purchase on a subscription

basis. The cybersecurity solution purchase are designed to defend against the kind of carpet bombing DDoS attacks that recently targeted a large number of high-profile platforms. The deal also included solutions from our service assurance offerings related to the customer's 5G expansion. The cybersecurity and service assurance purchases were implemented to improve the subscriber's user experience and to reduce churn among their 5G and Wi-Fi customers. In all, these developments reflect our momentum in executing our long-term strategy. With that, let's move to slide number eight to review our outlook. Looking ahead, we remain focused on driving product innovation, returning to annual revenue growth, and enhancing our margin through disciplined cost management. Accordingly, based on our strong first-half performance and our pipeline of opportunities, we are raising our revenue and earnings per share outlook. Tony will provide more details on the outlook in his remarks. As we navigate the second half of the fiscal year, we will continue monitoring the uncertain macro environment while remaining motivated by strong and positive customer feedback, including at our recent annual Engage Technology and User Summit. We hosted this event in September and showcased our latest solution focused on observability, AIOps, and cybersecurity. It is clear that our customers rely on our highly curated data to drive improved business outcomes across all ecosystems, which we believe positions us well to capture new opportunities through our differentiated solutions. As always, we are committed to empowering our customers to meet the demands of today's complex digital landscape by delivering mission-critical solutions that address performance, ensure availability, and safeguard security. We look forward to sharing our progress with you throughout the remainder of our fiscal year. With that, I will turn the call over to Tony.

Tony Piazza | Executive Vice President and Chief Financial Officer:

Thank you, Anil, and good morning, everyone. Thank you for joining us. I'll start by walking you through the key financial metrics for the second quarter and first half of our fiscal year 2026. After that, I'll share some additional commentary on our outlook for the remainder of the fiscal year, including some color on our expectations for the third quarter. As a reminder, other than revenue and balance sheet information, which is on a GAAP basis, this review focuses on our non-GAAP results and all reconciliations with our GAAP results appear in the presentation appendix. I will note the nature of any such comparisons accordingly. All comparisons are on a year-over-year basis unless otherwise noted as well. Slide number 10 details the results for the second quarter and first half of our fiscal year 2026. Focusing on the quarterly performance, total revenue for the second quarter increased 14.6% to $219 million. Product revenue increased 16.9% to $94.7 million, which benefited from the acceleration of certain orders expected in the second half. Service revenue increased 12.9% to $124.3 million, reflecting both underlying growth and favorable timing of maintenance renewals, including some back maintenance that was processed this quarter. Adjusting for these timing benefits across both areas, underlying total revenue growth for the quarter was in the mid-single digits year over year, demonstrating solid momentum in our business. The gross profit margin increased 1.7 percentage points to 81.4% in the second quarter, primarily driven by product volume and mix. Quarterly operating expenses increased by 11%, which, as previously disclosed, included the shift of our Engage User Summit into the second quarter compared to the third quarter last year, as well as the timing of commissions and variable incentive compensation. all of which are expected to normalize, resulting in a low single-digit increase in operating expenses for the full fiscal year. We reported an operating margin of 26.5 percent compared with 23.1 percent in the same quarter last year. Diluted earnings per share increased 31.9 percent to 62 cents. Let's turn to slide 11, where I'll walk you through the key revenue trends by product lines and customer verticals. As a reminder, revenue presented is on a gap basis, and all comparisons continue to be on a year-over-year basis. For the first half of fiscal year 2026, service assurance revenue increased by 10.1%, and cybersecurity revenue grew by 12.7%. During the same period, our service assurance product line accounted for approximately 65% of our total revenue, and our cybersecurity product line accounted for the remaining 35%. Turning to our customer verticals, for the first half of fiscal year 2026, our enterprise customer vertical revenue grew 12.7%, while our service provider customer vertical revenue grew 8.4%. 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%. Additionally, one

customer accounted for 10% or more of our total revenue during the second quarter, with no customer accounting for more than 10% of our revenue for the first half of fiscal year. Turning to slide 12, This slide shows our revenue split between the US and international markets. For the first half of fiscal year 2026, 57% of our revenue was generated from the United States, with the remaining 43% coming from international markets. Additionally, all geographies grew in the first half of the fiscal year. Slide 13 shows some key balance sheet items along with our free cash flow for the period. We ended the second quarter of 2026 with $526.9 million in cash, cash equivalent short and long-term marketable securities and investments, representing an increase of $34 million since the end of the fiscal year 2025. Free cash flow for the quarter was $4.3 million. During the second quarter, we repurchased approximately 741,000 shares of our common stock for approximately $16.6 million at an average price of $22.34 per share. We currently have capacity under our share repurchase authorization and, subject to market conditions, intend to remain active in the market during the remainder of fiscal year 2026. From a debt perspective, We have no outstanding balance on our $600 million revolving credit facility, which expires in October, 2029. As previously disclosed as a Q1 subsequent event, on August 4th, 2025, we completed the sale of our entire foreign investment highlighted in past quarters for the equivalent of $11.8 million. The original purchase price was $7.5 million. To briefly recap other balance sheet items, accounts receivable net was $130.2 million, representing a decrease of $33.5 million since March 31st, 2025. Day sales outstanding, or DSO, at the end of the second quarter of fiscal year 2026 was 51 days, compared with 53 days in the same period in the prior year. The improvement in DSO in the second quarter reflects the timing and composition of bookings. Let's move to slide 14 for commentary on our outlook. I will focus my remarks on our revenue and non-GAAP earnings per share targets for fiscal year 2026. As Neil noted, our strong first half performance gives us increased confidence in our full year outlook. We are raising our full year expectations for both revenue and non-GAAP diluted earnings per share from what we shared in August on our first quarter earnings call. We now expect revenue in the range of $830 million to $870 million, compared with our prior range of $825 million to $865 million. Non-GAAP diluted earnings per share is now anticipated to be in the range of $2.35 to $2.45, compared to our prior range of $2.25 to $2.40. The full year effective tax rate is expected to remain at about 20%, and we are assuming approximately 73 million weighted average diluted shares outstanding, reflecting our first half share repurchase activities. In closing, let me provide some color on our third quarter expectations. Given the acceleration of orders we saw in the second quarter, orders originally expected in the third quarter, we are anticipating third quarter revenue in the range of $230 million to $240 million. We expect non-GAAP diluted earnings per share in the range of 83 cents to 88 cents for the third quarter. That concludes my formal review of our financial results. Before we transition to Q&A, please note that our upcoming IR conference schedule is provided on slide 15. We will be attending the RBC Global TIMT and Needham Tech Conferences in November and the UBS Global Technology and AI Conference in December. We hope to see many of you at the events. Thank you, and I'll now turn the call over to the operator for questions.

Operator | Conference Operator:

Thank you. 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 that in the interest of time that you limit yourself to one question and one follow-up. We'll take our first question from Matt Hedberg with RBC Capital Markets. Please go ahead.

Simran | Analyst, RBC Capital Markets:

Hey, guys. This is Simran on for Matt Hedberg. Thanks for taking our question and congrats on the quarter. To start, I just want to double click on the strength that you saw in the quarter. Could you talk a little bit about the acceleration of orders that were originally expected in the second half and what drove that shift? And then on the Fed piece, that was also great to see. So if you could speak to some of the demand trends there as well.

Anil Singhal | President and Chief Executive Officer:

Well, I think this was always we are when we look at the Fed order specially, they are always on the edge of the end of the fiscal year. Sometimes we get it end of the federal fiscal year, which is September. So sometime in the past years also we get it afterwards. This time we got we had the reverse effect and second thing as Tony talked about, we had some big maintenance order which was recognized later in the year and those were the two big factors. Tony, anything else you think?

Tony Piazza | Executive Vice President and Chief Financial Officer:

No, those were two of the factors that pushed us into the exceeds expectations, but it was a strong federal quarter. Some of it, again, was the acceleration of that particular order. And we did see the acceleration, we believe, because

Simran | Analyst, RBC Capital Markets:

were prepping for the federal government shutdown so accelerated those orders uh into our second quarter to be prepared uh when that shut down so got it got it um and then just one more from me on jenny i could you speak to a little bit about what's been resonating with customers um on your AI ops offering and then how enterprise customers have been leaning into it. Thanks.

Anil Singhal | President and Chief Executive Officer:

Yeah, so I always talk about and you may have, I mean, in the script, you notice all the time we use the word differentiation because that's the starting point. Before we say we are better, we have to differentiate and get the earplugs out. So what's different for NETSCOUT in the generative AI and observability and AI world is that we have smart data telemetry, which we have never shared outside of our own applications in the past because the data lakes and other solutions were not ready to consume it, like companies like Splunk, ServiceNow, AWS, and things like that. So how we are differentiating is not that we have better algorithms in that area because there are so many available even in open source. We feeding smart data to algorithms in a unique way so that they have better outcomes. So we are basically using our branding as a smart data company, but that smart data was not experienced by third parties because we were not willing to share the data. So we created a new product called AI Science or AI Insight, basically, which allows it, makes it easier to mix our data with other data set, but more importantly, now they can apply their algorithms, whether it's in the chat GPT area or any other observability to our data, and that's very unique in the industry.

Simran | Analyst, RBC Capital Markets:

Great. Thanks, guys. Congrats again.

Anil Singhal | President and Chief Executive Officer:

Thank you.

Operator | Conference Operator:

We'll take our next question from Eric Seppager with B. Reilly. Please go ahead.

Eric Seppager | Analyst, B. Riley Securities:

Yeah, thanks for taking the question, and congrats on a very solid quarter. A couple questions. First off, on the 10% customer, can you comment as to whether that was a service provider, federal, or enterprise? And then on the threat landscape you talked about for denial of service, can you discuss how some of these attacks are evolving and whether your end customers are capable of defending against some of the changes in the attack landscape?

Anil Singhal | President and Chief Executive Officer:

So on the first part, Tony, you want to cover?

Tony Piazza | Executive Vice President and Chief Financial Officer:

Yeah, so on the first part, the 10% over 10% customers related to the federal government order. So it was a channel partners.

Anil Singhal | President and Chief Executive Officer:

OK, OK, on that on the second one that so when we talk about security area, we believe that DDoS market is underserved. A lot of people are looking at more sophisticated attacks. But the DDoS attacks are much, much more easier to orchestrate, and they are getting more sophisticated, but they are still easier to orchestrate, and they create a nuisance factor. Like, for example, a carpet bombing attack. A previous DDoS attack will attack a target or a server. A carpet bombing attack is an evolution of that. It's not that difficult to be orchestrated by botnets. which goes after multiple targets at the same time. So now instead of one server or 10 machines, you have hundreds of machines who have to defend themselves. So that's what is happening in the DDoS area. We believe that the industry is doing a great job outside of DDoS area, but within the DDoS area, it's only relegated to specialists and yet nation state actors and even the university students can orchestrate the DDoS attack. So what we did in the last three, four years is, as we integrated the Arbor DDoS business into NetStart, we brought our scalable DPI technology to that solution. And that was necessary to deal with these new and more sophisticated DDoS attacks.

Eric Seppager | Analyst, B. Riley Securities:

And what is the timing of some of this evolution? Is this taking place this year? Is this something that's been just kind of gradually evolving over a few years? And how is the state of the market right now?

Anil Singhal | President and Chief Executive Officer:

So we released an option to our product called Adaptive DDoS last year. And that includes this functionality. One of the reasons it's called Adaptive is that Adaptive DDoS option is sold as a subscription. and because we will keep adapting every six months a new release to deal with new attacks and people can just take advantage of that with their subscription so some of the adaptive ddos revenue is already in this year's numbers and by and so the adaptive ddos is our definition of dealing with these new and evolving attacks on a periodic basis through that option

Eric Seppager | Analyst, B. Riley Securities:

Very good. Thank you. Thanks.

Operator | Conference Operator:

We'll go next to Kevin Liu with Kay Liu and Company. Please go ahead.

Kevin Liu | Analyst, Kay Liu & Company:

Hey, good morning, guys, and I'll add my congrats on the results as well. First, just on the impact of the government shutdown, it certainly sounds like it accelerated some orders. I was wondering if you could talk about what's happening with kind of the existing pipeline there, whether deals are essentially paused or if they continue to move forward, and then

Tony Piazza | Executive Vice President and Chief Financial Officer:

whether there's any sort of fulfillable backlog that was associated with the government order secured and whether you know they would still continue to take those even amidst the shutdown um yes i mean i'll let and i'll talk a little bit about what his perspective on the government but with regard to the uh the uh the backlog or fulfillable orders there was some backlog related to the federal government order. And so we already have that order, and so that's already been fulfilled.

Anil Singhal | President and Chief Executive Officer:

Yeah, overall, I think the shutdown has not affected the non-federal business, and even federal business so far has not affected, but we are sort of watching it. And so if you look at uncertainty in the second half, potential uncertainty is the shutdown If it lingers on, it may affect, we are expecting more orders from the same customer. And second is the impact of tariff. That situation is still evolving. Potential impact of that on non-federal customers. So those are the things we are watching and continue to see whether that affects anything in the second half.

Kevin Liu | Analyst, Kay Liu & Company:

Understood. And Neil, since you mentioned the tariffs, to the extent those are rolled back, what sort of benefits would you expect to see either from your existing customer base or even if your own business has been impacted, which I don't think it has?

Anil Singhal | President and Chief Executive Officer:

You said benefit?

Tony Piazza | Executive Vice President and Chief Financial Officer:

Yeah, I think we haven't really seen any detriment of it at this point. From a business perspective, as we talked about before, given that a lot of our product comes from the Canada, the US and Mexico, and right now is protected under the various agreements. We haven't seen it. We haven't seen an impact from a cost perspective. From a customer perspective is I think what Anil is referring to is if they were to change

behavior, but we've heard noise around it, but really haven't seen a large impact.

Anil Singhal | President and Chief Executive Officer:

I think the impact will be like on the end user pricing not necessarily margin because we sell software which is very high margin so the potential impact on certain deals are budgets were set up let's say eight nine months ago we have long sales cycle six to twelve months and now if the tariff affects the total price of even the hardware portion which is uh they're buying it then we may have to just make them whole but it's just all up in the air right now, but we just need to watch.

Tony Piazza | Executive Vice President and Chief Financial Officer:

Kevin, just on the federal government, we do have a strong pipeline opportunity with the government, the federal government orders, and so we continue to look at that. I think we're a little bit insulated in the near term because of the pull forward of orders as they prepped for the shutdown. So we'll continue to watch that.

Kevin Liu | Analyst, Kay Liu & Company:

Got it. And just lastly, if I could ask about your product gross margin, that's as high as I've seen it before. Is there anything in terms of how you guys are going to market or which products are in demand from customers right now that's contributing to that? And how sustainable do you think this level is?

Anil Singhal | President and Chief Executive Officer:

I think the biggest part is that we are generally counting on selling our AI. And so we have two segments, as you know, that port business, DDoS and service assurance. The AI solution will be marketed to the service assurance customers. Largely that, I mean, less than 10% will be new customers. And a cybersecurity solution, which we call it Omni Cybersecurity, will be marketed to DDoS customers. So we are looking at these products as sort of adjacencies to the existing product line and yet attracting new budgets. So that's a good situation. And we don't need to hire a lot of sales people or train them to do that. Yet we have new opportunities.

Tony Piazza | Executive Vice President and Chief Financial Officer:

Yeah, so I'd say Kevin for the quarter product gross margin was in the high 80% range where it's typically in the mid 80% range and it was particularly strong given the volume of software in sales in the quarter and in the future we continue. You know, we're continuing to move more and more to software-related typesetting.

Kevin Liu | Analyst, Kay Liu & Company:

All right. That's helpful. Really appreciate you taking the questions. Thank you.

Anil Singhal | President and Chief Executive Officer:

Thanks, Kevin. All right.

Operator | Conference Operator:

Ladies and gentlemen, with no further questions at this time, this will conclude our call. Thank you for joining us today.