NASDAQ:NTCT Q3 2026 Earnings Call Transcript

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Operator | Conference Operator:

VP of Corporate Finance. Scott, please go ahead.

Scott | Vice President of Corporate Finance:

Thank you, Operator, and good morning, everyone.

Netscout Investor Relations | Investor Relations Representative:

Welcome to NETSCOUT's third quarter fiscal year.

Scott | Vice President of Corporate Finance:

investor relations section of our website at www.netscout.com, including the IR landing page and the quarterly results page. As discussed in detail on slide number three, today's conference call will include certain forward-looking statements about NETSCOUT'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 filings 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 for investors. While the slide presentation includes both GAAP and non-GAAP results, other than revenue and balance sheet information, which are presented in accordance with GAAP, we will focus our discussion on non-GAAP financial information. These measures should not be considered in isolation from or as a substitute for financial information prepared in accordance with GAAP. Reconciliations of all non-GAAP metrics 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 | President and CEO:

Anil. Thank you, Scott, and good morning, everyone. Thank you for joining us today. Our third quarter fiscal year 2026 revenue and earnings results were ahead of expectations. These results were enhanced by certain product orders and service renewal that had been anticipated for the fourth quarter as customers use their remaining calendar year budgets. The acceleration supported solid year-over-year results for the first nine months of our fiscal year, driven by growth across both our cybersecurity and service assurance options. Given our year-to-date performance, including the acceleration of certain orders and our current pipeline, we are raising the midpoint of our top and bottom line Outlook for fiscal year 2026. Let's turn to slide number six for a brief recap of our financial performance for the third quarter and the first nine months of fiscal year 2026. For the third quarter, total revenue was approximately $251 million ahead of expectations and in line with the same period last fiscal year. Diluted earning per share total $1 and increase of approximately 6% year over year. For the first nine months ended December 31, 2025, revenue was approximately $656 million, an increase of approximately 6% year over year, driven by solid growth in both our cybersecurity and service assurance offerings, which included the previously mentioned acceleration of certain orders. We expanded

both our gross and operating margins during the first nine months of the fiscal year can deliver diluted earnings per share of $1.96 up approximately 15% from $1.77 for the year-ago period. Now let's turn to slide number seven for some perspective on our business and some market insights. Starting with our service assurance offering, revenue in the first nine months of the fiscal year increased approximately 5% year-over-year. driven by growth in enterprise customer vertical with strong contribution from both federal and non-federal government-related spending. Within our service assurance offerings, our enterprise customers continue to advance their digital information initiatives, focus on AI advancement and observability at the edge, and we continue to innovate in those areas. Our recently released Omnis AI Sensor and AI Streamer work together as an AI solution to analyze, convert, and stream high-fidelity network packet data into actionable intelligence. The sensor captures traffic across complex environments while the streamer processes this data for real-time visibility. The result is reduced risk and faster troubleshooting for IT and security systems. In January, we announced the upcoming launch of the Ingenious Edge Sensor 795, which uses patented ASI technology and synthetic test analysis to generate the network smart data that enables continuous observability across modern enterprise environments. This launch reflects the expansion of our capabilities with respect to remote site observability, next generation Wi-Fi, and digital experience mapping with expanded healthcare support and digital experience monitoring. Among our service provider customers in the service assurance area, we continue to see measured investment in 5G-related initiatives as they balance that investment with monetization opportunities. As we have discussed in the past, some of the newer opportunities related to fixed wireless access and potential for 5G network slicing could potentially be real revenue drivers and cost savers for communication service providers. Network slicing services are scaling rapidly as 5G standalone adoption starts to accelerate, and we believe NETSCOT is well-positioned to support this advancement. In January, we announced how NETSCOT 5G observability solutions give communication service providers end-to-end visibility into 5G standalone network slices that support high-performance services like immersive gaming, large-scale live sporting events, and mission-critical applications like remote surgery. Moving to our cybersecurity offerings, revenue in the first nine months of the fiscal year increased 9% year-over-year, driven by growth in both our enterprise and service provider customer verticals. Organizations continue to invest in this area in response to a dynamic and complex cyber threat landscape. which, as we discussed last quarter, is explained in our latest research on evolving distributed denial-of-service attack landscape and how these attacks can destabilize critical infrastructure. This threat landscape continues to evolve rapidly, and we believe our adaptive DDoS and Omni Cyber Intelligence solutions are well-suited to the growing security needs of our customers. In fact, in December, NETSCOT Omni Cyber Intelligence with Omni Cyber Stream was named a 2025 CyberSecure Award winner by Security Today in the network security category. This recognition reflects the platform's strong market relevance and advanced capabilities, such as scalable deep packet inspection, real-time and historical analytics, and seamless integration to help security teams detect, investigate, and respond to digital threats. Additionally, in January, Frost and Sullivan named NETSCOT in its 2025 Global Company of the Year in the global network monitoring industry in recognition of our outstanding achievements in real-time visibility, performance assurance, and cyber-resilient network intelligence. The award cited NETSCOT leadership in delivering measurable results as well as our record of innovations across complex hybrid cloud and enterprise environments. We are honored by these recognitions and look forward to showcasing NETSCOT innovative solutions at upcoming industry events, including Mobile World Conference in early March and RSA Conference later that month. Customer wins. Moving on to customer wins, our service assurance cybersecurity solutions continue to gain traction with customers seeking to enhance their visibility, observability, AI, and cybersecurity capabilities. A few highlights for the third quarter include a mid-seven-figure order in our service assurance area from a new customer within the insurance industry. This customer engaged with us after their previous provider fell short in delivering a comprehensive, scalable visibility solution as the customer's need expanded to include greater cloud and AI functionality. They also sought to consolidate multiple tools in favor of a single, simplified platform. Overall, this engagement reflects a broader market trend. Organizations are prioritizing unified solutions built on high-quality data over fragmented tools that lack adaptability and scalability. Another service assurance win in the third quarter was a low seven-figure deal with an existing customer that is a large electric utility. Their focus on capacity expansion and using AI to improve safety and better monitor infrastructure health. This order included our AI

streamers, which transform high-fidelity packet-derived metadata into actionable intelligence. Customers are increasingly turning to NETSCOUT to support their AI initiatives and recognize that our high-quality smart data is an important component for successful AI and machine learning outcomes. In the cybersecurity area, we continue to see positive momentum. For example, we secured two additional mid to high seven-figure deals in Europe with existing customers. One is using our Omni Cyber Intelligence for forensic analysis, regulatory compliance, and threat analysis, along with our adaptive DDoS products to upgrade and expand their DDoS protection. The second is upgrading to our adaptive DDoS for its advanced capability, performance, and reporting features. In all, these developments reflect our success in executing our long-term growth strategy, as well as our strong position in the industry. With that, let's move to slide number eight to review our outlook. Looking ahead to the final quarter of our fiscal year, we remain focused on execution, as we pursue our key objectives of delivering product innovation, achieving a return to annual revenue growth, and enhancing our margins through disciplined cost management. We continue to successfully navigate a complex and dynamic microenvironment, including tariffs-related and AI-driven supply chain dynamics. Our software-driven model helps insulate us from some of that variability, though it could influence the timing and size of certain customer orders. That said, based on our performance over the first nine months and the strength of our pipeline, we are raising the midpoint of our top and bottom line outlook for the fiscal year 2026 while staying mindful of these external factors. Tony will provide more details on our outlook in his remarks. As always, we remain committed to helping customers meet the performance, availability, and security demands of today's digital landscape by leveraging the power of NETSCOUT AI-ready data platform. We look forward to sharing our progress with you after we complete the final quarter of our fiscal year. With that, I will turn the call over to Tony.

Tony | Senior 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 both third quarter and the first nine months of our fiscal year 2026. After that, I'll share some additional commentary on our outlook for the full fiscal year. As a reminder, other than revenue and balance sheet information, which are on a GAAP basis, this review focuses on our non-GAAP results. All reconciliations with our GAAP results appear in the presentation appendix. I will note the nature of any such comparisons accordingly. Also, all comparisons are on a year over year basis unless otherwise noted. Slide number 10 details the results for the third quarter and first nine months of our fiscal year 2026. Focusing on the quarterly performance, total revenue for the third quarter was $250.7 million, which was relatively consistent with the same period last year at $252 million, and ahead of our outlook provided last quarter. This outcome reflects the impact of timing-related shifts in customer purchasing behavior. As we noted last quarter, we had originally expected certain orders to land in the third quarter. However, a number of those were received earlier than anticipated in the second quarter. Similarly, in Q3, we observed some orders that we expected for Q4 being pulled forward as customers leveraged their remaining calendar year-end budgets. In some cases, this included service contract renewals, which included backdated maintenance components. While this dynamic provides short-term support to revenue this quarter, it's important to note that it can also create unevenness across reporting periods. We monitor and manage such changes closely, and we remain guardedly optimistic given the dynamic macro environment and the potential for variability in buying patterns as customers continue to manage their budgets conservatively. Product revenue totaled $121.7 million, compared with $128.2 million last year, primarily due to the timing of certain orders between quarters. Service revenue increased 4.1% to $129 million, reflecting both underlying growth and favorable timing of service renewal orders, some of which included backdated maintenance components, as well as the treatment of certain enterprise license agreements. Gross profit margin was 82.8% in the third quarter, consistent with the same period in the prior year. Quarterly operating expenses decreased 1.1% year over year to $117.6 million. The decrease reflects the previously disclosed benefit associated with shifting our annual Engage User and Technology Summit out of the third quarter, where it occurred last year, to our second quarter in this fiscal year. This benefit was partially off increase in employee related cost. Our operating margin increased to 35.9% compared to 35.6% in the same period last year. We delivered diluted earnings per share of $1, an

increase of 6.4% year over year. This improvement reflects, in part, the absence of a negative impact in the prior year period related to a foreign investment that we sold earlier in this fiscal year. This created a favorable year over year comparison for the third quarter, but the impact is not expected to have a material effect on our full year results. 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 nine months of fiscal year 2026, service assurance revenue increased by 4.8%, and cybersecurity revenue grew by 9%. During the same period, our service assurance product line accounted for approximately 64% of our total revenue, and our cybersecurity product line accounted for the remaining 36%. Turning to our customer verticals. For the first nine months of fiscal year 2026, our enterprise customer vertical revenue grew 9.4%, while our service provider customer vertical revenue grew 2.2%. During the same period, our enterprise customer vertical accounted for approximately 58% of our total revenue, while our service provider customer vertical accounted for the remaining 42%. Additionally, one customer and one channel partner each accounted for approximately 10% of our total revenue during the third quarter, with no customer accounting for more than 10% of our revenue for the first nine months of the fiscal year. Turning to slide 12, this shows our revenue mix between the U.S. and international markets. For the first nine months of fiscal year 2026, the U.S. represented 57% of revenue and international represented 4.3%. Slide 13 shows some key balance sheet items along with our free cash flow for the period. We ended the third quarter of fiscal year 2026 with $586.2 million in cash, cash equivalent, short and long-term marketable securities and investments, representing an increase of $93.7 million since the end of the fiscal year 2025. Free cash flow for the quarter was $59.4 million. From a debt perspective, we had no outstanding balance on our $600 million revolving credit facility, which expires in October 2029. We currently have capacity under our share repurchase authorization and subject to market conditions, intend to be active in the market during the remainder of fiscal year 2026 and into fiscal year 2027. To briefly recap other balance sheet items, accounts receivable net was $234.6 million, representing an increase of $70.9 million since March 31st, 2025. Date sales outstanding at the end of the third quarter of fiscal year 2026 was 82 days, compared with 75 days in the same period in the prior year. The change in DSO in the third quarter reflects the timing and composition of bookings. Let's move to slide 14 for our outlook. I will focus my remarks on our revenue and non-GAAP earnings per share targets for fiscal year 2026. We are raising the midpoint of our fiscal year 2026 top and bottom line outlook ranges. This outlook reflects our solid execution, the continued demand for our solutions and the resilience of our business model. Revenue is now expected to be in the range of $835 million to $870 million, representing a 3.6% year-over-year growth at the midpoint. Although we are not guiding to a specific number within the range, to provide a little color, performance around the midpoint reflects our current directional view based on what we know today, while the broader range captures the timing-related factors Anil mentioned earlier. This compares to our prior outlook of $830 million to $870 million. Non-GAAP earnings per diluted shares now expected to be within the range of $2.37 to $2.45, compared to the previous range of $2.35 to $2.45. A reconciliation between our GAAP and non-GAAP numbers is included in our earnings release. The full-year effective tax rate is expected to remain at approximately 20%, and we are assuming approximately 73 to 74 million weighted average diluted shares outstanding, reflecting our repurchase activities for the first nine months of the fiscal year. That concludes my formal review of our financial results. Before we transition to Q&A, please note that we will be on the road over the coming months meeting with investors and look forward to continuing our dialogue. With that, let's open it up for questions. Operator?

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. In the interest of time, we ask that you limit yourself to one question and one follow-up. Our first question is from Matt Hedberg with RBC Capital Markets. Your line is open.

Simran | Analyst, RBC Capital Markets:

Hey, guys. This is Simran for Matt Hedberg. Thanks for taking our question, and congrats on the quarter. I guess to start, so Kuebner's performance was good relative to expectations, realizing that the quarter benefited from some deal pull-ins. And it sounds like you guys are seeing healthy demand trends, but can you comment on if some of those demand signals are actually improving?

Anil | President and CEO:

Well, we talked about the demand signals are similar or improving, but we also are cautious about some of the supply chain challenges, which could delay the timing of the orders, because even though we are a software company, they have to run our software on servers. And if there are delays in procuring the servers, which we don't control, then that could delay in the software procurement process also. But in terms of demand for both our current solution and future offering and interest in AI-based solution, user for data for those use cases, I think it's equal or better than versus maybe six months ago.

Tony | Senior Vice President and Chief Financial Officer:

Yeah, I would just comment that. It's really, it's really about timing versus demand, because demand remains strong. We have a robust pipeline. And so we've benefited from acceleration. And it's just a matter of timing in some of these deals, given the dynamic environment that and some of the factors that Anil had mentioned.

Simran | Analyst, RBC Capital Markets:

OK, got it. That makes sense. And then as a follow-up, could you quantify the pull-ins this quarter? And does your Q4 guide assume any additional deal pull-ins?

Tony | Senior Vice President and Chief Financial Officer:

So the pull-ins were, say, approximately $15 million, a combination of product revenue and service revenue. It impacted both. And right now, we've given that range Timing, again, is really the factor, and although we're not guiding to a particular number, what we see right now is something around the midpoint, and so it doesn't factor in a lot of pull-ins or anything at this point.

Operator | Conference Operator:

Okay, great. Thanks, guys. We'll take our next question from Eric Supiger with B. Reilly Securities. Your line is open.

Eric Supiger | Analyst, B. Riley Securities:

Yeah, thanks for taking the question. Congrats on a solid quarter. First off, can you walk through just how the budgets worked where customers were pulling orders from the March quarter into December? Because I don't typically think of pulling budgets from one calendar year into another calendar year the way they do maybe from Q4 of the calendar year into Q3. And then secondly, can you talk a little bit about the use case that is deriving the service assurance It seems like your enterprise business was strong and could you just provide some detail about what kind of maybe AI use cases are driving the service assurance uptick that you saw?

Anil | President and CEO:

Good thanks Eric. So I think first of all, I mean it's always interesting because many of our customers are not on the same fiscal year as we are and that has left our budget for them. Even though it's a quarter three for us, it's a quarter four for them. And sometimes it takes time to budget to set in in the new fiscal year. So if they have a demand and they want to use up all the budgets they can, and that's what happens typically all the time. This time we saw even in Q2 because of the federal fiscal year ends at that time. Now coming back to service assurance, at some point we might start separating some of the AI revenue, but it's too small right now. But if you look at, there are two use cases of our data in the service assurance market. One is the traditional service triage, where somebody says, you know, I have an IT issue, and why don't you use NETSCOT product to troubleshoot? And so our smart data, which is our differentiator, we have over 100 patents in that area, which converts in real time packet data or conversation data to telemetry, that was not benefiting the use case outside our own applications because they didn't have the ability to consume that and in the future even agentic AI can take advantage of that. So AI use cases simply mean that you can use the slightly enhanced data which is used only by our own application in service assurance, can now be mixed with other use cases for companies like Splunk or, as I mentioned, Agentic AI. And so we are now IT people and other businesses can use it for similar data for other purposes, and that's our AI use case. So now we are not just limited to the use case of the application NETSCOT had developed, which is the ingenious one, but can also be used for AI-related use cases, which is a, I mean, big variety of those.

Eric Supiger | Analyst, B. Riley Securities:

Okay. A quick comment on how much that was a contributor in the quarter?

Anil | President and CEO:

I don't know in the quarter, but maybe for the nine months, it was about 15 million. Yeah.

Eric Supiger | Analyst, B. Riley Securities:

Very good. Thank you.

Netscout Investor Relations | Investor Relations Representative:

Yeah.

Operator | Conference Operator:

We'll take our next question from Kevin Lu with K. Lu and Company. Your line is open.

Kevin Lu | Analyst, K. Lu & Company:

Good morning, guys. Let me add my congrats as well here. Maybe starting with your service provider business, obviously there are various competitive dynamics and they're all kind of impacting both the wireless folks and the traditional cable MSOs a little differently. So just wondering what you're seeing in terms of kind of their appetite to spend, whether there's any sort of difference between kind of the two sides of the coin there.

Anil | President and CEO:

Well, first of all, they may have their own competitive dynamic between the carriers. There is no competitive dynamic versus NETSCOUT. I mean, most of the players are privatized companies and they're much, much smaller than us. And in some sense, they're struggling for budgets and things like that. Yeah, we do have price pressures from them. And so when there is RFP, we have to deal with the next best players. and usually the competition is pricing, which sometimes affects our deal size. What is happening on the service provider side is, and especially U.S., there have been big layoffs at some of the many companies, and despite some of the monetization opportunity of 5G slicing, there's constant pressure, certainly in the service assurance area. But we are hoping there will be less pressure even for these people in the cybersecurity and AI area. But our AI initiative, it is very early stage. So we think that service assurance portion of service vital will continue to be challenging next year also. But it'll be more than made up by a good or better environment in DDoS and definitely in the new areas of AI is all upside.

Kevin Lu | Analyst, K. Lu & Company:

I'm just going to appreciate the color there. And just wanted to parse out, you know, some of the impacts to you guys on supply chain, specifically around component costs and availability. I know you guys ship more of it software only nowadays, but just wondering, you know, how you're feeling about your ability to maintain kind of your product growth margins given the cost environment. And then to your point on just kind of shortages potentially impacting timing. Are your customers starting to order a product from you with longer lead times and you guys will carry more backlogs? Or how are they responding to kind of the current potential for shortages?

Anil | President and CEO:

So lead time for NETSCORE, very few people buy our appliance-based product, which hardware comes from us, and we have enough supply there to deal with that. But we sell less and less of those nowadays. So the lead times of the hardware, they buy directly from the server vendors like Dell and all those. those are really impacted and they might impact timing of software order also. And so far, we have not seen a big impact related to that, but moving forward, they could be tied together and we might see some delayed order. As time comes to margins, since we are not shipping the hardware, the increased cost for the servers, which they use to run our software, doesn't really impact our margins. It affects the timing and timing of the orders, definitely timing for deployment, but it doesn't affect the margin. Tariff impact has been very small, but yes, that impacts some margin only for short-term deals when customer says, I have allocated only so much money for the hardware, and so we may have to discount the software slightly and it may have a small impact on the margin, but we have not seen much so far.

Tony | Senior Vice President and Chief Financial Officer:

And I would just echo what Anil says. It's really more about does it affect our customers' timing and behavior versus our direct cost, because the majority of our revenue is in services and software. And so in our cost of sales, the direct material cost isn't that significant. And so any implications on that can be managed or mitigated through either price increases, working with our vendors on absorption, or if we had to absorb something ourselves. So we don't see the cost element as material to us.

Kevin Lu | Analyst, K. Lu & Company:

Understood. Thanks for taking the question.

Anil | President and CEO:

Thank you.

Operator | Conference Operator:

And this does conclude the question and answer portion of today's call. And this does conclude the Netscouts third quarter fiscal year 2026 financial results conference call. Thank you for your participation. You may now disconnect.