Agilent Technologies

Agilent Technologies Fourth Quarter Fiscal 2018 Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you, and welcome everyone to Agilent's Fourth Quarter Conference Call for Fiscal Year 2018. With me are Mike McMullen, Agilent's president and CEO, and Bob McMahon, Agilent's senior vice president and CFO.

Joining in the Q&A after Bob's comments will be Jacob Thaysen, president of Agilent's Life Science and Applied Markets Group; Sam Raha, president of Agilent's Diagnostics and Genomics Group; and Mark Doak, president of the Agilent CrossLab Group.

You can find the press release and information to supplement today's discussion on our website at www.investor.agilent.com.

While there, please click on the link for "financial results" under the "Financial Information" tab. You will find an investor presentation along with revenue breakouts and currency impacts, business segment results and historical financials for Agilent's operations. We will also post a copy of the prepared remarks following this call.

Today's comments by Mike and Bob will refer to non-GAAP financial measures. You will find the most directly comparable GAAP financial metrics and reconciliations on our website.

Unless otherwise noted, all references to increases or decreases in financial metrics are year over year. References to revenue growth are on a core basis. Core revenue growth excludes the impact of currency, and acquisitions and divestitures within the past 12 months. Guidance is based on exchange rates as of October 31st.

We will also make forward-looking statements about the financial performance of the company. These statements are subject to risks and uncertainties and are only valid as of today. The company assumes no obligation to update them. Please look at the company's recent SEC filings for a more complete picture of our risks and other factors.

Before I turn the call over to Mike, I would also like to share my plans to retire at the end of January making this my last conference call as Agilent’s vice president of investor relations. I have enjoyed working with many of you over the years, but as Mike says the best is yet to come and so it is also true for IR.

And now, I’d like to turn the call over to Mike.

MIKE MCMULLEN

Thanks, Alicia.

Hello everyone, thank you for joining us today.

Before I cover our financial results, I want to thank Alicia for her years of service and wish her the best in her retirement. Alicia has superbly lead Agilent’s IR team for the past 8 years. She has set a high standard with her professionalism, integrity and transparency in her engagement with the investment community. Thank you, Alicia – you are the best and will be missed by me and our Agilent team – and I am sure – by the audience on today’s call.

This quarter, we are reporting our strongest quarterly results since the 2015 launch of the New Agilent. We are ending the year with a terrific quarter. Our revenues, profitability and earnings per share are significantly ahead of expectations.

Now, some of the specifics:

Q4 revenues grew 9 percent on a core basis to $1.29 billion. This exceeded the high-end of our guidance by more than $30 million.
Double-digit end-market growth in Pharma, Environmental & Forensics, along with continued strength in our Chemical & Energy business are driving results.

Geographically, our China business is up sharply with 16 percent growth for the quarter. For the year, the Agilent China team delivered double-digit growth and achieved a major milestone - crossing over $1B in business for the first time.

Q4 adjusted operating margin is 25.2 percent, up 190 basis points from last year. This is our 15th consecutive quarter of the Agilent team improving year over year operating margins.

Q4 adjusted EPS of 81 cents, is 7 cents above the high-end of our guidance. Compared to last year, this is an increase of 21 percent.

In addition, we took advantage of market conditions to purchase $86 million in stock during the quarter. For the full year, stock repurchases stand at $422 million – underscoring the confidence we have in our future performance. I am also pleased to report that the Agilent Board has just approved a new 1.75 billion dollar share repurchase plan.

This quarter's performance caps off an excellent 2018. Our strong quarterly performance translates into full year core growth of 7.1 percent – our highest annual growth rate since the launch of the New Agilent. Total reported revenues grew to $4.9 billion.

We continue to deliver improved profitability while investing for growth. For the year, adjusted operating margin is 23.1 percent, up 110 basis points over last year.

Our earnings per share are up 18 percent for the year to $2.79.

The numbers tell the story – a strong team delivering yet another stellar annual performance.

Let's now look at the quarter by business groups.

Core revenues grew a healthy 9 percent for LSAG, our Life Sciences and Applied Markets group. Product strength is broad based driven by Mass Spec, Chromatography and Cell Analysis.

We continue to introduce innovative new products. We are strengthening our molecular spectroscopy portfolio with the launch of the Agilent 8700 Laser Direct Infrared chemical imaging system. This is a breakthrough in both chemical imaging and spectral analysis. We also introduced the Cary 3500 UV-Vis system – the first significant advancement in UV-Vis architecture in decades.

We continue to build our cell analysis business. We just closed the acquisition of ACEA Biosciences. ACEA is a provider of cutting-edge cell analysis instruments and will expand our cell analysis portfolio.

The Agilent CrossLab group delivered strong 9 percent core revenue growth. Demand was excellent across both services and consumables.

We continue to invest in our portfolio and extending our customer reach. We completed the acquisition of ProZyme, expanding our offering in the bio-pharma market place.

We also acquired our South Korean distributor. This acquisition expands our direct customer engagement and further builds out ACG's service business in this market.

The Diagnostics and Genomics Group grew 5 percent on a core basis. Strength in our NASD and genomics businesses drove the quarterly results.

In a significant win, Agilent has been selected by Unilabs to be a Preferred Partner for their pathology business. Unilabs is one of the largest European diagnostic testing lab providers. This announcement is another strong testament to the advantages of Agilent's staining workflow solutions.

Before I leave DGG, I want to provide an update on the construction of our new NASD API production facility. We remain on track for the initial production of GMP grade API's by the end of fiscal 2019 with material revenue contributions in FY20.

Overall, it was a great quarter, capping off an excellent year delivered by the Agilent team.

A few final comments before I turn the call over to Bob.

Agilent's shareholder value creation model is fully activated. First, we are executing on an innovation driven growth strategy that is delivering. Second, we continue to focus on improving profitability with our Agile Agilent initiatives. Finally, we are actively leveraging our balance sheet to drive acquisitions of fast-growing, innovative companies while also returning cash directly to shareholders.

We have transformed Agilent into a growth company -- and are focused on delivering superior earnings growth. We just delivered our highest growth and profitability since the launch of the new Agilent. Since then, our adjusted CAGR EPS is up 17 percent.

Our business is also less cyclical today with non-instrument sales making up over 56 percent of our total company revenue. If economic challenges would arise, our business is now less dependent on capital equipment purchases.

Looking ahead to 2019, while acknowledging current trade discussions, we are expecting market conditions to remain solid. The Agilent team is laser focused on sustaining our strong growth into 2019 and beyond. …..We have momentum.

I keep telling the Agilent team – “the best is yet to come.”

Thank you for being on the call, and I look forward to answering your questions … I will now hand off the call to Bob. Bob?

BOB MCMAHON

Thank you, Mike and good afternoon everyone. I am very pleased to be talking with you today on my first earnings call as Agilent’s CFO. Before I get started, I want to echo the comments Mike made and say thank you to Alicia. In my time here, she has been a great partner to me and I truly wish her the best in retirement. She will be missed.

Now moving to the financials.

In my remarks, I am going to provide some additional detail on revenue, walk through the fourth quarter income statement, touch on a few other key financial metrics, and then I’ll finish with our financial guidance for 2019. Unless otherwise noted, my remarks will focus on non-GAAP results, and percentage changes will be on a year-over-year basis.

As Mike mentioned, we delivered a very strong fourth quarter to finish an excellent fiscal year.

Revenue for the quarter was $1.29 billion, with core revenue growth of 9 percent, exceeding both our guidance and expectations. For the full fiscal year, our core revenue growth was 7.1 percent, a very strong performance.

As Mike spoke to the Group’s performance for the quarter, I will provide some additional details around our end market and regional performance.

Overall, the market environment is positive, and based on our channel reach and product offerings, we saw broad strength across most end markets.

Pharma, our largest end market, was up 14 percent with double-digit contribution from all business groups. Both the small molecule and biopharma segments performed well. Traditional areas of strength as well as newer areas of strategic focus such as cell analysis and a strong performance at NASD contributed to the result.

Chemical & Energy grew an impressive 7 percent against a very strong comparison of 15 percent core growth last year. We continue to see positive on-going market investment in this area. Balanced gains in both LSAG and ACG were driven by strength in spectroscopy, LC-MS, supplies and services. Demand from materials characterization applications continues to drive robust ICP/MS growth.

Environmental & Forensics grew 17 percent, ahead of expectations, with good demand across major regions. Growth was balanced across both end markets. Forensics saw notable demand for Cobalt Raman spectroscopy, and Environmental for LC-MS and ICP-MS.

Academia and Government reported 10 percent growth as funding environments stabilized, while Diagnostics and Clinical grew 1 percent and Food was flat as expected against a tough 10 percent comparison.

Geographically, we also saw broad-based strength. China grew by 16 percent, accelerating from the 10 percent core growth we saw in Q3, and as Mike mentioned passed the billion $ mark in sales for the year in the fourth quarter. Other Asia and Japan grew by 12 percent and Europe and the Americas had solid mid-single digit growth.

In addition, we continue to be pleased with the revenue composition as non-instrument revenue contributed 56 percent of the total in Q4. Looking forward, we see non-instrument revenue growth out-pacing instrumentation driving an increasingly “recurring” revenue stream.

Turning to the rest of the P&L, Q4 gross margin of 57.8 percent increased 170 basis points compared to the prior year. This was due to product mix and volume as well as our Order

Fulfillment and Supply Chain organization continuing to do an outstanding job driving cost savings using our Agile Agilent approach.

Operating margin, including adjusting for the Keysight billings, was 25.2 percent, up 190 basis points due to higher gross margins and top line leverage on operating expenses, even as we invested more in R&D.

This led to non-GAAP earnings per share of $0.81 in the fourth quarter, an increase of 21 percent compared to the prior year, and more than double the rate of revenue growth.

Before moving to FY19 guidance, I want to touch on a few additional financial metrics.

We continue to generate very strong cash flow. This quarter free cash flow was $336 million and for the year we generated over $900 million in free cash, exceeding our commitment.

In Q4, we returned $133 million to shareholders, buying back 1.3M shares for $86 million, and paying out $47 million in dividends. We also completed the ProZyme and Young In acquisitions – with Young In we expanded our direct sales and service capabilities in South Korea.

For the fiscal year we returned $613 million to shareholders, buying back 6.4 million shares for $422 million, and paying out $191 million in dividends. As Mike mentioned, we closed a record number of acquisitions in 2018, deploying $516 million.

We ended the year with $2.2 billion in cash and $1.8 billion in debt.
And we just closed on ACEA Biosciences last week. So, we are starting 2019 where we left off in 2018.

All in all, we enter 2019 with healthy end markets, good momentum in the business and a very strong balance sheet.

Now, let's turn to our non-GAAP financial guidance for the full year and first quarter of 2019, beginning with our full year guidance.

We expect 2019 to be a strong year overall, but before I get into the actual numbers, let me mention a few important points.

First, we anticipate currency will be a headwind in 2019. Based on exchange rates as of the end of October, we expect currency will reduce reported sales growth in 2019 by roughly 220 basis points, translating into roughly a $110 million negative impact for the full year. For comparison, our 2018 reported sales growth benefited by 210 basis points from currency.

Partially offsetting the currency impact will be a larger contribution from recent M&A, including the recently closed ACEA Biosciences acquisition.

In addition, starting in fiscal year 2019, we adopt a new accounting standard which changes how we present pension expenses and benefits on the income statement, in effect reclassifying certain amounts to other income/expense. While this has no impact to net income, we do expect this will reduce forecasted operating margins in FY19 by roughly 40 basis points. As we move through the year, we will provide a restated 2018 to provide an apples to apples comparison.

Lastly, we are taking a different approach and setting guidance ranges that includes both upsides and downsides, so I would encourage you to model to the midpoint of guidance at this stage.

For the full year, we are expecting revenue to range from $5.13 billion to $5.17 billion in fiscal 2019, representing core growth of 5.0 to 5.5 percent and associated reported growth of 4.4 to 5.2 percent. Currency is estimated to negatively impact growth by 2.2 percentage points with M&A contributing roughly 1.6 to 1.9 percentage points of growth for the full year.

Now on to our EPS guidance. For the full year, we are forecasting a range of $3.00 to $3.05 per share. Adjusting for the negative currency, this translates to 9 to 11 percent growth in EPS and is

7.5 to 9.3 percent on a reported basis. Included in this guidance is roughly $4M per quarter in tariffs. This is slightly higher than the estimate we provided last quarter and is related to list 3.

A few other metrics as you build your models. Embedded in our forecast is modest operating leverage after accounting for the pension adjustment. We are also expecting the total of interest income, interest expense and OI&E to be $10 to $15 million in net expense, inclusive of pension and Keysight billings. Guidance is based on a full year tax rate of 17 percent, down a point from 2018 and diluted shares outstanding of approximately 322 million, flat to Q4 of this year.

We expect operating cash flow of between $1.1 billion to 1.15 billion and capital expenditures of roughly $175 million.

As previously mentioned, the Agilent Board has authorized a $1.75B repurchase program and we plan, at a minimum, to offset dilution throughout the year. We will also continue to look for M&A, like ACEA and the other recent tuck-ins, and have the financial flexibility to be opportunistic in share buybacks as well.

Finally, we have announced raising our dividend by 10 percent continuing a streak of double-digit increases providing another source of value to our shareholders.

Turning now to Q1 guidance.

For Q1, we are expecting revenue to range from $1.265 billion to $1.280 billion, representing reported growth of 4.4 to 5.7 percent and core growth of 4.5 to 5.5 percent. Please remember that we are going against a very tough Q1 compare last year where we grew 10 percent core.

First-quarter 2019 non-GAAP earnings are expected to be in the range of $0.71 to $0.73 per share, which is roughly 9 to 12 percent ex currency and 7.6 percent to 10.6 percent reported growth.

Before opening the call for questions, let me conclude by saying we are very pleased with the financial results and the continued hard work and focus of the Agilent team laying the groundwork for future growth and as we enter 2019 with strong momentum.

With that, I will turn it back to Alicia for the Q&A.