Agilent Technologies

Agilent Technologies Third Quarter Fiscal 2017 Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you, and welcome everyone to Agilent's Third Quarter Conference Call for Fiscal Year 2017. With me are Mike McMullen, Agilent's president and CEO, and Didier Hirsch, Agilent's senior vice president and CFO.

Joining in the Q&A after Didier's comments will be Patrick Kaltenbach, president of Agilent's Life Science and Applied Markets Group; Jacob Thaysen, 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 Didier 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, the NMR business, and acquisitions and divestitures within the past 12 months. Guidance is based on exchange rates as of the last business day of the reported quarter.

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.

And now, let me turn the call over to Mike.

MIKE MCMULLEN

Thanks, Alicia. Hello, everyone and thank you for joining us today.

Q3 marked another strong quarter for the Agilent team. We exceeded our own expectations on both the top and bottom line. We continue to deliver above-market growth. Our revenues of $1.11 billion grew by 7 and a half percent on a core basis. Adjusted EPS of 59 cents is up 20 percent over last year's third quarter. Our focus on operational excellence continues to pay-off. We delivered an adjusted operating margin of 21.5 percent, up 90 basis points from a year ago.

I remember when I became Agilent's CEO, you asked a very good question: Could Agilent make the adjustments to improve our operating margin while outgrowing the market? "Well, we have." This is the 10th consecutive quarter of improving core operating margins while outgrowing the market.

So where is our strong Q3 growth coming from? From an end-market perspective, both the global Chemical & Energy and Pharma markets grew by 10%. And geographically, China continues to be strong, while we experienced better than expected growth in Europe.

Let's take a closer look at what's happening in our end-markets.

Our Pharma revenue is up 10 percent. We are well-positioned to capture growing customer demand with our broad and differentiated offerings of instruments, services and consumables. Demand was also strong for our API offerings.

Chemical & Energy is up 10 percent. This is the second consecutive quarter of double-digit growth. Similar to last quarter, growth was broad-based across regions and products. Our customers are beginning to upgrade their labs and are investing in equipment replacements. While some uncertainty remains on the pace of recovery, we are encouraged by the reinvestment.

After four consecutive quarters of decline, we had a nice surprise with the low-single digit core growth in Academia and Government. Strength in Europe and double-digit growth in cell analysis, spectroscopy and services drove our results.

Food grew 2 percent against a difficult compare in Q3 last year. Food market fundamentals remain sound with strength this quarter in Europe.

Environmental and Forensics grew a healthy 7 percent. Our strong growth was driven by Asia Pacific and the Americas. Concerns about the health of our environment continue to drive the Asia market.

Diagnostics and Clinical grew by 6 percent, led by pathology and companion diagnostics and geographically, strength in Europe.

Now turning to look at our different regions. Geographic performance was driven by double-digit growth in Europe and continued China performance. The Americas grew by mid-single digits, while Japan was flat.

And now let’s turn to the highlights from our business groups.

The Life Sciences and Applied Markets Group delivered core revenue growth of 7 percent. From an end-market perspective, strength in Chemical & Energy, Pharma and Environmental continue to drive the performance.

Looking at our product portfolio, growth is broad across all our products. And we continue to strengthen our line-up.

We recently introduced several new additions to our InfinityLab LC series. At ASMS, we unveiled our newest LC-MS triple quad, the Ultivo. It is not an exaggeration to say it's revolutionary. The Ultivo is 70% smaller than previous instruments, yet it still delivers the same or better performance than its predecessor. Our customers tell us that the triple quad is the workhorse of the lab. The Ultivo allows our customers to maximize their lab space and increase capacity without compromising performance or uptime. This revolutionary new instrument is a great example of Agilent's market expertise and commitment to customer-centric innovation.

We also strengthened our GC-MS line up with the introduction of a new high-resolution, accurate-mass system. This new product will help our customers address the growing demand for identification of unknown chemical samples.

We look to buy businesses in fast growing, adjacent market segments with differentiated offerings and strong teams. In July, we completed the acquisition of Cobalt Light Systems, adding Raman spectroscopy to our spectroscopy line-up. Cobalt Light Systems has developed ground breaking technology that is integrated into an innovative suite of benchtop and handheld instruments. We are now directly participating in this fast-growing spectroscopy market segment. There are strong synergies between the two companies. We are scaling the operations of Cobalt Light Systems and will be offering our current customers these ground-breaking solutions.

CrossLab, a key strategic move of the New Agilent, continues to pay-off. The Agilent CrossLab Group maintained its strong performance again this quarter, with core revenue growth of 8 percent. Growth was robust for both services and consumables.

The Diagnostics and Genomics Group also delivered strong core revenue growth of 8 percent. Results were driven by strong demand for our pathology products and companion diagnostics services. We see particular strength for our PD-L1 and molecular products. As I mentioned earlier, our Nucleic Acid Solutions business, which can be “lumpy”, performed well and is up by very strong double digits.

The growth we saw in our Pathology business is a strong sign that we are regaining market share with our automation system, OMNIS, and the new products we are continuing to introduce. From special stains to new ready-to-use antibody offerings, our Pathology Division is creating a lot of momentum.

We also introduced our newest next-generation sequencing library prep solution — Agilent SureSelectXT HS. This research solution benefits our customers by streamlining the entire NGS workflow.

On the M&A front, we acquired the molecular and sample barcoding patent portfolios of Population Genetics Technologies. This expansion of our IP portfolio bolsters our target enrichment leadership position – enabling the future introduction of new solutions to our customers. Rapid integration of the Multiplicom business continues to proceed according to plan.

Let me close out my portion of the call, recapping the journey of the New Agilent and with some comments on our Q4 outlook. In May of 2015, at our first analyst and investor day of the New Agilent, we laid out an ambitious 3-year plan to create shareholder value. We made three commitments. We committed to outgrow the market. We committed to improve adjusted operating margins over 400 basis points. We committed to take a balanced approach to deploying our capital. Over the past 10 quarters we have been delivering on our commitments.

I am so proud of this team. We are on the cusp of achieving the goals that we set for ourselves - and that we first shared with you over two years ago. We are a team that delivers on its commitments. I think it is now time to retire the description “New Agilent”. We have put in a new foundation for the company to grow and we are firmly focused on the future. The achievement of these goals is just the beginning. Our story is a forward-looking story with a laser focus on delivering superior earnings growth and creating shareholder value.

Looking at the more immediate future, I want to close with a few comments about Q4’17. First, we remain somewhat cautious about the potential for a cyclical recovery. We are also heading into a period of “tough compares” for our global Pharma and China businesses. Yet, the overall market environment for Agilent is stronger than forecasted coming into this year. Given these considerations, we are once again raising our full-year core growth and earnings expectations.

I look forward to answering your questions later in the call... and will now hand off to Didier. Didier will provide additional insights on our Q3 results and updated guidance. Didier?

DIDIER HIRSCH

Thank you, Mike, and hello, everyone.

As mentioned by Mike, we delivered strong top and bottom line results, both on a year-over-year basis and versus our guidance. Currency had a positive impact on revenue and operating profit of respectively $7M and $1M versus previous guidance. Please note that we have reduced our pro-forma tax rate by 1 percentage point, which had a 2 cents impact on our Q3 EPS.

I will now turn to the guidance for our fourth quarter.

We expect Q4 revenues of $1.15B to $1.17B and EPS of 60 to 62 cents. At midpoint, revenue is expected to grow 3.5% on a core basis. As a reminder, our core revenue growth last Q4 was a strong 6.3%, so Q4 is a tough compare, coming after an easier Q3 compare. Versus previous guidance, currency is estimated to have a positive impact of $24M on revenue and $4M on operating profit. Our 22.4% adjusted operating margin at midpoint will be up 90 bps sequentially.

Now to the guidance for Fiscal Year 2017. The Q4 guidance is expected to result in the following fiscal year guidance:

- At midpoint, revenue is projected to grow 6.0% on a core basis, or 1 percentage point over the previous guidance. The revenue guidance of $4,445M is $75M over previous guidance including $31M due to currency and $1M to M&A.

- Our EPS guidance of $2.30 at midpoint is up 12 cents from previous guidance and corresponds to a 16% year-over-year increase.

- Currency contributed 1 cent and the reduction in pro-forma tax rate contributed 3 cents.

- Adjusted operating margin for the year is expected to be 21.8% or 110 bps higher than in FY16.

- Finally, we are raising our operating cash flow guidance from $825M to $850M and reducing our capex guidance from $200M to $185M, leading to an increase in free cash flow guidance of $40M.

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