Agilent Technologies

Agilent Technologies Second Quarter Fiscal 2018
Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you, and welcome everyone to Agilent's Second Quarter Conference Call for Fiscal Year 2018. 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 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 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, and acquisitions and divestitures within the past 12 months. Guidance is based on exchange rates as of April 30th.

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 turning the call over to Mike, I would like to remind you that Agilent will host its annual analyst and investor meeting in New York City on June 6. Details about the meeting and webcast are available on the Agilent investor website.

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

<u>MIKE MCMULLEN</u>

Thanks, Alicia.

Hello everyone, thank you for joining us on today's call.

Before I discuss the Q2 financial highlights with you, I would like to welcome Jacob Thaysen and Sam Raha to their first earnings call in their new roles.

Most of you know Jacob from his former role as the President of Agilent's Diagnostics and Genomics Group. He now has transitioned into a new role as the President of our Life Sciences and Applied Markets group. Sam is replacing Jacob as the new President of Agilent's Diagnostics and Genomics Group.

Sam, as you may recall, rejoined Agilent a year ago as Senior Vice-President of Corporate Strategy and Business Development. Both Jacob and Sam have extensive backgrounds in life sciences, wide industry knowledge and connections. Both are highly experienced at building and leading large organizations. Agilent is fortunate to have a deep leadership bench to draw upon to fill these two roles.

Now, let me turn to our Q2 financial performance. I can report that the Agilent team delivered another strong quarter. Our momentum continues.

Our core revenue growth of 4.3 percent is at the mid-point of our guidance. Our adjusted EPS of 65 cents, exceeded our expectations and is above the high-end of guidance. Our adjusted EPS is up 12 percent from a year ago. We delivered an adjusted operating margin of 21.9 percent. On a currency adjusted basis, this is our 13th quarter in a row of improving operating margins.

After two strong quarters to start the year, our core growth now stands at 7 percent, with an adjusted operating margin of 22.2 percent and an adjusted EPS up 19 percent.

I am making some references to our first half results, as the Lunar New Year had a material impact on the timing of our reported revenues.

In Q1, our Chinese customers requested deliveries earlier than anticipated. As a reminder, this pulled in approximately $10M of revenue from Q2 into our first quarter. In Q2, we also estimate that the reduced number of “selling days” due to the Lunar New Year had a negative impact of close to $10M on our ACG annuity business. These two factors reduced Q2’s reported company growth by two percentage points.

Back to our Q2 results and turning to our end markets, Pharma, our largest business, continued its strong showing with 8 percent growth. Strength in Mass Spectrometry, consumables, services and genomics led the results. Growth was strong in both the Bio-Pharma and Small Molecule market segments. We remain very confident in achieving our 2018 Pharma growth objectives.

Our Chemical and Energy market revenues grew 5 percent in-line with our expectations and against a difficult compare of 14 percent growth last year. The global Chemical and Energy market environment remains favorable, although we note a slight pause among our US customer base, which may be attributable to some concerns about trade policies.

We grew 2 percent in Academia and Government driven primarily by strength in LC/MS, Cell Analysis, and our CrossLab services and consumables business.

Diagnostics and Clinical grew 3 percent led by strength in our Reagent Partnership and Genomics businesses and offset continued weakness in the U.S. Pain Management market.

Food revenue was down 1 percent, reflecting the initial impact of the Chinese government reorganization of the food safety ministries.

On March 21st, the Chinese government announced the creation of the National Market Supervision Administration (NMSA), consolidating many previous independent agencies such as AQSIQ, SFDA and SAIC into one market supervisory agency.

This is resulting in a temporary slowing of new instrument purchases as ministries are being consolidated and decision-makers are being clarified. We expect the reorganization to take as long as one year to be completely finished with an expected slowdown of six to nine months in new instrument purchases.

Environmental and Forensics grew 2 percent, driven by strong gains in our global Forensics business.

In March, the Chinese government also announced some changes to the structure of the Environmental ministries. These changes, however, are not as large as those to the Food market ministries. While we did see some slowdown in new instrument purchases, we expect business to return to higher levels of growth in the next quarter or two.

Geographically, the Americas and Europe grew strongly, with high-single-digit growth. China was flat in Q2 due to the timing impact of the Lunar New Year, and the recently announced changes to the government Food and Environmental ministry agencies. For the half, our China team delivered strong 9 percent core growth.

Now, I will cover some of the highlights from our business groups.

The Life Sciences and Applied Markets Group delivered core revenue growth of 3 percent. Growth in Chemical & Energy remained robust offsetting the weakness in the Food testing market. From a product perspective, we saw strength in LC/MS, Cell Analysis and ICP/MS. Our new LC-MS, Ultivo, continues to be well-received by the market and perform ahead of our targets.

On the M&A front, we announced the acquisition of Advanced Analytical Technologies, Inc. Agilent is known as an innovator in capillary electrophoresis based instrumentation, and this acquisition will add complementary technologies to our portfolio. The regulatory review is underway.

After the quarter end, we also announced plans to acquire Genohm, which closed today. Genohm is a developer of highly differentiated, on-premise and cloud-based software solutions for laboratory management. The Genohm team will join Agilent as part of our LSAG group. Customers are looking to do more with their data. By integrating Genohm’s platform into our OpenLab portfolio, Agilent will extend its OpenLab value proposition to encompass the management of all the context and content in the lab.

We continue to build our cell analysis business. In collaboration with BioTek Instruments, we announced a new, integrated solution that combines cellular metabolic analysis and imaging technologies. This collaboration provides new capabilities to our Agilent Seahorse analyzers, which help biologists measure cell activity in real time.

Agilent CrossLab Group continued its consistent, outstanding performance with 7 percent core revenue growth. Gains across our major end-markets were led by double-digit growth in Pharma and Academia & Government. Performance was balanced across consumables and service. China delivered double-digit growth and all other geographies grew in mid- to high-single digits.

During the quarter, we made progress on our mission to improve both the science and the economics of our customers' laboratories.

We introduced an innovative and extremely stable new GC column that is receiving a very positive response from customers. ACG Services is expanding its Agilent Enablement Services Pilot to include additional platforms across Agilent. The pilot is aimed at improving the customer's onboarding experience by shortening their time-to-value after they purchase our solutions. We also opened a new Global Solution Development Center in Singapore to meet the increasing demand for integrated end-to-end solutions.

Our online capabilities continue to gain momentum. Our China online business has seen double-digit growth since the beginning of the year. And, our China WeChat Services program has attracted more than 13,000 active customers since its rollout at the end of last year.

The Diagnostics and Genomics Group delivered core revenue growth of 4 percent, as expected, led by strength in our Genomics business.

On the innovation front, we introduced several new products this quarter. Our launch of the HRP Magenta for the Dako Omnis, Agilent's flagship instrument for immunohistochemistry and in situ hybridization, allows pathologists to more easily visualize cancer in skin and lung tissues. We continued to expand our portfolio of in situ hybridization probes with the release of several new probes for Omnis to maximize our differentiation in automated ISH staining.

On the Genomics side, we enhanced our industry leading target enrichment portfolio for next-gen-sequencing. Our recent introduction of the SureSelect All Exon V7 is being well-received by customers—as it improves both performance and cost-effectiveness. On the Genomics informatics front, we released a new module for the Alissa Clinical Informatics Platform. This new module further simplifies the informatics processes and accelerate time-to-results for our customers.

We continue to invest for future growth. We signed a definitive agreement to acquire the remaining shares of Lasergen, and closed the acquisition on May 7th. As many of you will recall, we made an initial investment in Lasergen in 2016 for a 48-percent ownership stake.

This acquisition brings into Agilent a powerful sequencing chemistry and a world-class group of scientists and engineers, dedicated to bringing our integrated clinical workflow solution for molecular diagnostics to the market. We are very excited to have the Lasergen scientists and engineers on the One Agilent team. We expect to invest about $35M per year to deliver our molecular clinical workflow solution to the market in 2020.

Now, let me provide a few remarks on where we are in our journey at Agilent and our outlook for the rest of the year.

The Agilent team continues to execute and our momentum remains. We are right where we want to be for the first six months of the year. We delivered strong growth, while improving operating margins and deploying our capital in a balanced manner. Once again, our EPS growth is in the double-digits.

Our R&D innovation engine continues to strengthen our portfolio. We also are adding new capabilities through M&A. We believe this combination of organic growth-driven investments and complementary M&A together with our execution capabilities will deliver continued strong growth relative to the market.

For the past three years, our focus has been on building a company foundation. A foundation that would leverage the One Agilent company culture, innovation and execution capabilities -- to generate above-market growth and earnings expansion. Our platform for top-line and earnings growth is now in place. We are delivering.

When we were rebuilding the company, I also wanted to focus on making the company more agile and responsive to our market environment.

Looking forward, we continue to proactively assess market forces and move in an agile manner to capture the most promising opportunities.

As you know, our two largest end-markets are Pharma and Chemical & Energy. Through the first half of this year, our Pharma performance has been above our expectations, and we are raising our full-year Pharma outlook. Our full-year guide for the Chemical and Energy market business remains unchanged with expected strong mid- to high-single digit growth.

Geographically, we are bringing down our expected full-year growth rates in China to about 7 percent as a result of the expected pause in business from the realignments of the government agencies. At the same time, we remain confident in the strength of our European and Americas businesses and have raised our full-year outlook for these geographies from our Q1 guide assumptions.

While there are some end-market and geographic "give and takes," our overall model remains intact. Following the significantly raised guidance last quarter, we are reaffirming our full-year core growth and earnings guidance, inclusive of currency headwinds and increased investments in our molecular clinical workflow offering.

The Agilent team is confident, energized and excited about our future, our next phase of growth and delivery of results. We are looking forward to sharing more about what is behind this outlook in our upcoming Analyst and Investor Day.

Thank you for being on the call, and I look forward to answering your questions – and seeing you in June.

I will now hand off the call to Didier, who will share more insights on our Q2 financials and updated outlook. Didier?

DIDIER HIRSCH

Thank you, Mike, and hello, everyone.

As Mike stated, we delivered another strong performance this quarter and year-to-date.
For the quarter, our core revenue growth of 4.3% was in line with our guidance, and we overdelivered on OM and EPS. Our core revenue growth would have been more than 1 percentage point higher if not for ICPMS shipment delays and the recently announced reorganization of Chinese government ministries. Our adjusted operating margin of 21.9% was 40 basis points above the implied guidance, and EPS of 65 cents was 3 cents above. Further adjusting for currency, the operating margin was 22.4%, which was 30 bps above last year and, as highlighted by Mike, represented our 13th quarter of increased year-over-year operating margin. We delivered $303M in operating cash flow. During the quarter, we bought back 674K shares of Agilent stock for a total of $46M and paid $48M in dividends.

I will now cover the guidance for Fiscal Year 2018. We are maintaining our core revenue growth guidance of 5.5%, even as we anticipate that the reorganization of Chinese government ministries may push out about $20M of revenues into FY19. We are also maintaining our EPS guidance of $2.65 cents while absorbing $22M or 6 cents for FX and our technology investments in Lasergen and Genohm. Regarding Lasergen, we forecast to spend $15M this second half, and about $35M in both FY19 and FY20, when we plan to commercialize our solution. There is no change to our operating cash flow guidance of $1.05B and capex guidance of $200M.

I will now turn to the guidance for our third quarter. We expect Q3 revenues of $1.185B to $1.205B and EPS of 61 to 63 cents. At midpoint, revenue will grow 4.3% on a core basis.

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