Agilent Technologies

Agilent Technologies Third Quarter Fiscal 2018 Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you, and welcome everyone to Agilent's Third 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.

I am also pleased to announce that Bob McMahon is joining us on the call today, as well. As you know, he will be taking on the role as Agilent's CFO in September due to Didier's retirement at the end of October.

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 July 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.

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

MIKE MCMULLEN

Thanks, Alicia.

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

Before I discuss the Q3 financial highlights and our updated outlook, I am pleased to have Bob McMahon join the call. Bob is an excellent choice for Agilent's next CFO and a very capable successor to Didier.

Bob brings a strong track record of leadership to our team. Many of you already know Bob from his previous role as CFO of Hologic. He officially assumes the CFO role beginning September 1st. As Didier hands off the baton, he will serve in an advisory capacity until his retirement at the end of October. Bob and Didier are working together to ensure a smooth transition.

I first met Bob over coffee in Palo Alto, where we shared our perspectives on business and company culture. We had an important conversation about values and their importance in business. I knew immediately that Bob would be a great fit for the Agilent culture. And of course, his management style and business acumen are a perfect match for our approach to creating shareholder value. Bob has joined Agilent at an exciting time. I'm confident he will help us lead the next phase of Agilent's growth.

While I am very excited to have Bob join the Agilent team, I will greatly miss Didier's partnership and counsel. He has played a key role in the transformation of the company and our excellent business results. It's important for the CEO to have a very capable CFO – I couldn't have asked for a better partner. So, thank you Didier, you will be missed by me and our Agilent team.

Now, let me turn to our Q3 financial performance. The Agilent team delivered another strong quarter with both growth and earnings exceeding our expectations.

Our core revenue grew 6 percent and is above the high-end of our guidance.

Our adjusted EPS of 67 cents is four cents above the high-end of our guidance, despite currency "headwinds" since our last guide. This is a 14 percent increase from a year ago. We delivered an adjusted operating margin of 22.6 percent, which is an increase of 110 basis points from a year ago. This marks our 14th consecutive quarter of improving our core operating margins.

Let's take a closer look at our results by our end markets:

We continue our strong Pharma performance, with 8 percent core growth. This is against a tough compare as we grew 10 percent in Q3'17. We see strength across all of our business groups with particularly strong performances in Mass Spectrometry, Cell Analysis, CrossLab's consumables and services, and Genomics. Growth remains robust in both the Bio-Pharma and Small Molecule market segments.

Our Chemical and Energy market revenue grew 12 percent. We are quite pleased with this strong growth – again, against a difficult, prior year compare of 10 percent. On-going market investment remains positive. This is in spite of the tariff rhetoric and retaliatory policies you are hearing in the news. From a product perspective, strength in Spectroscopy, GC, CrossLab's consumables and services is driving this result. Geographically, strong gains in China and Europe are leading overall global growth.

Revenue grew 3 percent in Academia and Government, in line with expectations. Strong performances from Cell Analysis, Molecular Spectroscopy, ICP/MS and CrossLab's services and consumables are driving the results. China and the rest of Asia are delivering double-digit growth in this end market.

Diagnostics and Clinical revenue grew 5 percent led by strength in Genomics and our Reagent Partnership business. This offset continued challenges in the U.S. Pain Management market.

Food revenue declined 1 percent. Strength in the Americas is being offset by declines in Europe versus a tough compare of 35 percent growth rate last year. And, as expected, China instrument sales were also down this quarter.

Environmental and Forensics is flat this quarter. Forensics growth was offset by the expected temporary slowing of instrument sales in China Environmental.

Geographically, let me start with an overview of China. Our overall China business remains strong – growing 10 percent this quarter. Strength in China is being driven by double-digit growth in our two largest end-markets: Pharma and Chemical and Energy. Our CrossLab and DGG businesses also grew by "double digits." We continue to expect healthy overall market conditions. This is more than offsetting any temporary slowing of instruments sales in the Food and Environmental markets.

The business is also strong in the Americas and the rest of Asia outside of China, with these two regions delivering healthy high single-digit growth. Europe was flat on a tough compare of 12 percent.

In summary, we delivered a strong quarter with broad-based strength and standout performances in the Pharma, Chemical and Energy and China markets.

Now, let's discuss the results from our three business groups.

The Life Sciences and Applied Markets Group delivered core revenue growth of 5 percent. This result is being driven by robust growth in the Pharma and Chemical and Energy markets. From a product perspective, LC/MS, Cell Analysis, and ICP/MS are leading the results. Ultivo, our "game-changing" LC-MS QQQ continues to be well-received. Geographically, demand in the Americas and China are leading the results.

Let me share a few examples of how we are executing on our strategy to increase the depth and breadth of LSAG's solutions portfolio.

On the M&A front, we closed on the acquisition of Genohm in early May. Genohm complements Agilent's informatics capabilities by adding laboratory management services. By integrating Genohm's LIMS platform into our OpenLab portfolio, we can provide complete and integrated informatics solutions to our customers.

Customers are very focused on Informatics as a way to create insight and drive lab efficiencies. We are determined to lead in lab informatics. For example, last week Agilent released the first software supporting the new standardized data format called the Allotrope Data Format or ADF for short. This format was created by a consortium of pharmaceutical companies for the pharmaceutical industry. By standardizing the collection, exchange, and storage of analytical data captured in laboratory workflows, labs will be able to transfer and share data across platforms. We are proud to be the first company to develop and launch a commercial product to support this standard. We believe the adoption of standards like ADF will both shape the future of lab informatics and drive the adoption of our solutions.

In addition, our internal LSAG innovation engine continues to deliver. We just released the Agilent Seahorse XF Real-time ATP Rate Assay kit. This new -- and unmatched -- product will enable biologists to enhance their understanding of how live cells function in real-time. We are a leader in live cell analysis and continue to expand our offerings in this fast-growing market.

The Agilent CrossLab Group continued its outstanding performance with 8 percent core revenue growth. Gains across our major end-markets were led by “double digit” growth in Chemical & Energy and strong results in Pharma and Food. Performance was balanced across consumables and service. China led growth in all regions with mid-teens growth.

CrossLab is a key growth driver of the new Agilent. We are delivering on our mission to improve both the science and the economics of our customers’ labs. As we expand and strengthen the CrossLab platform, we are creating more value for our customers and Agilent.

For example, during the quarter we announced two acquisitions that will further expand our consumables portfolio. We acquired the business assets of Ultra Scientific, a provider of chemical standards and certified reference materials. On August 1st, we also acquired ProZyme, a provider of biopharma consumables for glycan analysis. As you know, glycan analysis is essential to the development of biotherapeutic drugs – and we will now directly participate in this fast-growing Bio-Pharma market segment.

We continue to invest and build on our leadership position in China. We recently opened a new logistics hub in Shanghai. This hub will enable faster delivery of parts, supplies and consumables to laboratories. This is the first of five forward stocking locations we are establishing. This allows us to improve our service and the speed at which we support our customers.

Our focus on digital investments is also delivering results and gaining traction. Our digital channel orders are growing at a record pace. For the first-time ever, over 50 percent of our consumables orders are now digital. China is leading the charge on this front. We are improving the customer buying experience, expanding our customer reach and driving growth.

The Diagnostics and Genomics Group delivered core revenue growth of 5 percent. Excluding our NASD business, which declined as expected in the quarter, the DGG group delivered core revenue growth of 7 percent against a tough compare. Let me further explain.

As we have mentioned previously, NASD revenues are batch-based, which can make the revenue vary from quarter to quarter depending on the timing of customer acceptance. As expected, the business declined in the quarter as it was going up against 45 percent growth in Q3 of last year – we expect the business to return to growth in Q4. As I mentioned, without this "variability of reported revenue" effect this quarter, our core DGG business grew 7 percent.

A few additional comments on our NASD business. I just returned from a visit with our team in Colorado. The capacity expansion underway will allow us to meet the growing demands for GMP grade oligonucleotides and CRISPR offerings. I'm pleased with our progress on our new facility and the strong market environment. For example, just last week, one of our customers, Alnylam Pharmaceuticals received FDA approval for Onpattro – a "first of-its-kind" targeted RNA-based therapy to treat a rare disease. This is wonderful news for Alnylam and most importantly, their patients. NASD remains a long-term growth play for Agilent and I am excited about the future.

Back to the overall DGG results. Strong results were driven by "double digit" growth in Genomics and strength in our Reagent Partnership business. Geographically, outstanding growth in China and Japan drove the results.

We continue to strengthen our ability to support the fight against cancer and other diseases. Burning Rock Dx received China FDA approval for their human lung cancer NGS detection kit. Agilent SureSelect reagents are used as part of this panel. And our own PD-L1 companion diagnostics product received expanded U.S. FDA approval in cervical cancer.

During the quarter, we completed the acquisition of AATI, Advanced Analytical Technologies, Inc. AATI provides capillary electrophoresis-based solutions for fully-automated analysis of a range of molecules. This acquisition builds on Agilent's existing expertise, providing customers with a more comprehensive set of solutions for NGS workflows and other applications. NGS is driving and will continue to drive strong growth for this new business to Agilent.

With the addition of the AATI team, we created a new Biomolecular Analysis Division within DGG. This new division now also includes our complementary microfluidic business, previously part of our LSAG group. Didier's team has reflected this change in our current financials along with accompanying financial restatements.

Now, let me provide a few remarks on where we are on the Agilent journey and our near-term outlook before turning the call over to Didier.

Let me start with a few comments on tariffs. On the customer side, we are not yet seeing any changes in customer buying behavior. On the duty front, we have planned for and have taken actions to partially offset the impact of expected increases in tariff related duties.

This proactive approach resulted in a small $500K impact on our Q3 results. In Q4, we expect an impact of approximately $3.5M of incremental duty costs, or approximately 1 cent of EPS, which has been incorporated into our latest guidance. Looking into 2019, if the tariffs remain in place, we plan to aggressively reduce the remaining effect via potential changes in our prices and further adjustments to our supply chain.

For some time, we've been on a path to increase shareholder value. We've been focused on delivering strong growth, while expanding core operating margins and putting our strong cash flow and balance sheet to work in a more impactful manner.

Q3 results demonstrate our continued commitment to creating value for our shareholders and customers. We delivered another quarter of strong operating results, while deploying our capital, as committed. We returned $291 million in capital to shareholders through repurchasing $243 million of our own shares and paying out $48M in dividends. We are also investing in the business. We closed 4 acquisitions, paying out $430M in the quarter and announced 2 more acquisitions. This is a record number for Agilent — and will further strengthen our company's foundation for growth.

As we continue aggressively strengthening our portfolio via the Agilent innovation engine and M&A, we are also continuing to execute on our Agile Agilent customer experience and efficiency improvement initiatives.

The twin drivers of our success continue to be a strong portfolio and a customer-focused way of doing business.

Now, a few words about our outlook going forward. The Agilent team continues to capitalize on healthy end markets. We remain confident in our outlook. We are increasing our full-year core growth and earnings guidance. Didier will walk you through the details – but we are raising our guidance for core revenue growth, operating margin, and EPS.

The Agilent team remains committed, confident, and energized about our future. In our Agilent DNA is our team's ability to drive customer-focused innovation coupled with operational excellence. It is this powerful combination that will continue to fuel our future growth and earnings expansion.

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

I will now hand off the call to Didier, who will share more insights on our Q3 financials and guidance. Didier?

DIDIER HIRSCH

Thank you, Mike, and hello, everyone.

First, let me express my appreciation for Agilent employees' passion and professionalism in accomplishing their mission, creating shareholder value, and finally for their support throughout the years. With Mike's continuing leadership and Bob's contribution, I am convinced that "the best is yet to come" for Agilent.

As mentioned by Mike, we delivered strong top and bottom line results, both on a YOY basis and versus our guidance.

On the revenue front, we beat our mid-point guidance by $14M, after excluding currency headwind of $11M and contributions from our two recent acquisitions, AATI and Ultra Scientific, of $5M. Our core revenue growth of 5.9% was well over the mid-point guidance of 4-¼%.

Our adjusted OM of 22.6% was 110 bps over last year's and 120 bps over guidance, and we delivered a core OM incremental of 55%. EPS was 5 cents above the mid-point of our guidance. During the quarter, we bought back 3.76M shares for a total of $243M and paid $48M in dividends. Finally, we repatriated $1.5B of our offshore cash.

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

We expect Q4 revenues of $1.24B to $1.26B and EPS of 72 to 74 cents. At midpoint, revenue is expected to grow 4.7% on a core basis. Versus previous guidance, FX is projected to have a negative impact of $21M on revenue and $2M on OP.

Our 23.6% adjusted OM at midpoint will be up 100 bps sequentially, and up 30bps on a YOY basis, even after funding the Lasergen R&D. The increase in tariffs, effective early July, is expected to have a negative impact of $3.5M, as we have initiated actions to our supply chain. When those actions are complete, mid 2019, we expect the net annualized impact to be approximately $9M, excluding potential pricing actions.

Now to the guidance for Fiscal Year 2018. The Q4 guidance is expected to result in the following fiscal year guidance:

First, at midpoint, revenue is projected to grow 6.1% on a core basis, or 60bps over the previous guidance. The revenue guidance of $4.87B is $10M over previous guidance, including $22M due to the acquisitions of AATI, Ultra Scientific, and Prozyme, with currency having a negative impact of $32M. Second, our EPS guidance of $2.70 at midpoint is up 5 cents from previous guidance and corresponds to a 14% year over year increase. Third, adjusted OM for the year is expected to be 22.6% or 60 bps higher than in FY17. And fourth, our core OM incremental is expected to be 39% for the FY, at the high end of our operating model.

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