Agilent Technologies

Agilent Technologies First Quarter Fiscal 2019 Conference Call Prepared Remarks

ANKUR DHINGRA

Thank you, and welcome everyone to Agilent's First Quarter Conference Call for Fiscal Year 2019. 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, investor presentation and information to supplement today's discussion on our website at www.investor.agilent.com.

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 the acquisitions and divestitures completed within the past 12 months. Guidance is based on exchange rates as of January 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 for joining our call today.

I’d like to start by welcoming Ankur to his first earnings call as our vice president of investor relations. While Ankur is new to this role, he is not new to Agilent — excelling in senior level finance roles for over 16 years. I believe many of you on this call have already met Ankur. In case you have not, I want to reiterate a key theme he is sharing – we remain committed to sustaining excellence in our IR team and maintaining a strong relationship with you, the investment community. We miss Alicia but are very pleased to have such a capable successor in Ankur.

Now on to the Q1 results:

2019 is off to a strong start. The Agilent team continues to deliver excellent results with both revenues and earnings exceeding our guidance.

Q1 revenues totaled $1.28 billion. This represents 6.1 percent core growth against a tough Q1 2018 compare. Our performance is highlighted by double-digit growth in both our Agilent CrossLab and Diagnostics and Genomics groups. From an end-market perspective, our results were led by double-digit growth in the Pharma, Clinical & Diagnostics and Environmental & Forensics markets.

Our Q1 operating margin is 23.1 percent, an increase of 120 basis points from last year. Our Agile Agilent programs are driving process and productivity improvements, while we also continue to invest for the future. This is our 16th consecutive quarter of the Agilent team improving year-over-year operating margins.

Our Q1 adjusted EPS of 76 cents is up 15 percent. This is 3 cents above the high-end of our guidance. The combination of strong topline growth and increased margins is driving continued double-digit growth in our EPS.

Now looking at results across our businesses:

Our Life Sciences and Applied Markets group grew 1 percent on a core basis against a very tough compare of 11 percent growth last year. Demand remains strong in the Pharma and Environmental & Forensics markets.

We continue bringing to the market innovative new offerings to fuel future growth. Earlier this month in Japan, we strengthened our leadership position in Gas Chromatography with the global launch of two innovative new instruments – our new 8890 GC, replacing our flagship 7890 GC offering, and an all new mid-range 8860 GC.

In addition to leading analytical performance, reliability and robustness, these two “Smart Connected” instruments offer several compelling new digital capabilities including remote connectivity. Customers can now remotely control the instrument, monitor its status and perform diagnostic tests providing a new level of convenience for busy lab managers and chemists.

With our intelligent predictive technology, we also can provide our customers with System Health Alerts, or autonomous monitoring of instrument performance, allowing them to avoid unscheduled downtime and maximize laboratory productivity. These are great examples of our Digital Lab strategy in action.

Complementing the introduction of the Intuvo GC in 2016, we now have the most complete and compelling gas chromatography portfolio in the industry. While early in the global launch of these two new offerings, customer response is very positive.

We continued to strengthen our fast-growing Cell Analysis business. Building from our "beachhead" acquisition of Seahorse Bioscience in 2015, we acquired Luxcel Biosciences last year adding new cell assay capability. We continue to invest in the fast-growing Cell Analysis market space. Earlier this quarter, we opened a state-of-the-art cell assay development facility in Cork, Ireland. We also acquired Acea Biosciences in Q1, adding highly complementary new products to our cell analysis portfolio. The acquisition of ACEA Biosciences increases the relevance and impact we can have with our customers in this quickly evolving space.

LSAG's innovation leadership again received external recognition as we drive for increased market share in molecular spectroscopy. The Analytical Scientist ranked the Agilent 8700 LDIR System as a 2018 top innovation. This "ground breaking" imaging spectroscopy system takes a new approach to chemical imaging for customers in the pharmaceutical, biomedical, food and materials science markets. The system delivers greater speed and clarity enabling faster, more informed decisions for customers.

These new products from our LSAG team further strengthen an already impressive line of instrumentation and software. We are very well positioned for continued market share gains.

Our Agilent CrossLab group delivered excellent results, growing 10 percent on a core basis in Q1. Demand was broad-based across all end-markets and regions, which speaks to the strength of our customer value proposition.

Our ACG team continues to expand our digital capabilities for the lab and improve the customer experience. We introduced eSubscriptions that allow customers to set up reoccurring consumable orders online. This provides customers with the ease and convenience of not having to place repeated orders. We also launched a Smart Alert subscription service for the GC installed base, providing lab managers with alerts on instrument maintenance needs based on their actual applications and sample volume.

Over the past several years, ACG has worked diligently on an expansion of our portfolio, building outcome-oriented solutions and enabling our on-line business. Our Q1 results are reflective of all the ACG team's work to bring these capabilities to market and set us up well for continued growth in the future.

The Diagnostics and Genomics Group delivered exceptionally strong results this quarter with 12 percent core revenue growth. Demand was strong across all businesses and regions.

Our pathology related businesses, which comprise roughly half of the Diagnostics and Genomics business, grew low-double digits in the quarter. Importantly, we continue to partner with our customers in efforts to fight cancer. This quarter, we expanded our portfolio in high-volume cancer diagnostic testing. In Europe, we launched the first PD-L1 pharmDx kit on the Dako OMNIS automated platform. We are also working on bringing this PDL-1 assay on Omnis to the U.S. and other markets.

Our NGS related business again grew double digits this quarter.

The NASD business is also very strong. Our plans to bring the second facility online to expand production remain on track. We anticipate the initial production of GMP grade API's by the end of fiscal 2019 with material revenue contributions in FY20.

Looking at Agilent's performance on a geographic basis — the Americas market led with high-single digit growth, and we saw low single-digit growth in Europe and China.

As we expected, China's Q1 growth rate is lower than our expectations for full year growth. This is owing to an extremely tough compare versus a 19 percent core growth last year. As you know, there has been a lot of conversation about the China market. While there are some "puts and takes" within the markets we serve, our view is that overall market demand remains solid.

Now turning to the total company outlook.

Our Q1 results, coupled with our current view of market conditions and Agilent's strong execution capabilities, set us up to deliver a strong 2019. As a result, we are increasing our full-year guidance. Bob will soon share the specifics, but before handing off the call to Bob, let me close with a few summary comments.

Looking ahead, I remain cautiously optimistic. Cautious as we observe the overall macro conversation about the ongoing U.S. – China trade discussions and questions about the health of the China and European economies.

And, optimistic as we continue to see solid demand in most end-markets and geographies, as we continue to successfully build a high-growth, high-margin recurring revenue business across our ACG and DGG groups, and as we continue to strengthen and expand our LSAG instrument and software portfolio.

The Agilent team is delivering on its commitment to drive superior revenue and earnings growth. Our company has never been stronger. The guidance increase reflects our confidence in the strength of the Agilent business and our One Agilent team.

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?

<u>BOB MCMAHON</u>

Thank you, Mike and good afternoon everyone. In my remarks today, I will provide some additional detail on revenue, walk through the first quarter income statement and some other key financial metrics, and then I'll finish up with our updated guidance for Q2 and the full year. 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 strong Q1, so a good start to the fiscal year. Revenue for the quarter was $1.28 billion, with core revenue growth of 6.1 percent, exceeding our guidance.

Reported growth was also 6 percent, as currency negatively impacted growth by 220 basis points and was offset by M&A contributing 210 basis points of growth.

Mike spoke to the business groups' performance for the quarter, so I will provide some additional details around our end markets and regional performance.

Pharma, our largest end market, delivered 10 percent core growth. The growth was broad based across all business groups. We are seeing traditional areas of strength in BioPharma, but also in newer strategic focus areas such as cell analysis. We are excited about the addition of Acea Biosciences, which expands our portfolio in this fast-growing segment of the market. In addition, a strong performance at NASD contributed to the results.

Chemical & Energy core growth was 2 percent against a very strong comparison of 13 percent last year and was in-line with expectations. Instrument sales were effectively flat versus mid-teens gains last year, while services and consumables delivered solid mid-single digit growth.

Environmental & Forensics was up 10 percent even as we faced a tough low-teens compare last year. Double digit growth in ACG and high single digit growth in LSAG were driven by strength in GC/MS, GC, Atomic Spectroscopy, Consumables, and Services.

Wrapping up our end-markets, Diagnostics and Clinical core revenue grew 11 percent, while both Academia and Government and Food were effectively flat.

Geographically, as Mike mentioned, we saw growth in all markets. The Americas region delivered high single digit core growth as our commercial team continues to execute at a high level while Asia, outside of China grew low double digits. Both Europe and China grew by low single digits against difficult compares of 9 percent and 19 percent respectively.

Before I leave revenue, I want to mention we continue to be pleased with our evolving revenue mix as non-instrument revenue contributed 57 percent of total sales in the quarter. This revenue has been higher growth and historically less cyclical revenue. It's contribution this quarter is more than 1 percentage point higher than Q1 of last year. We expect this trend to continue as we leverage our large installed base and provide value added services and solutions for our customers.

Now turning to the rest of the P&L, Q1 gross margin was 56.9 percent and increased 10 basis points compared to the prior year. Our teams have been able to offset the higher costs of tariffs with productivity improvements.

Operating margin was 23.1 percent, up 120 basis points mainly due to top line leverage on operating expenses, even as we invested more in R&D.

Before I leave operating margin, I want to remind you this fiscal year we adopted the new pension accounting standard and have restated prior years for comparison purposes. There is no net impact to our non-GAAP earnings per share.

Consistent with our guidance, our Q1 tax rate was 17 percent, down a point versus a year ago and average diluted shares were 322 million.

This led to non-GAAP earnings per share of $0.76 in the first quarter, an increase of 15 percent compared to the prior year.

Before moving to FY19 guidance, I want to touch on a few additional financial metrics on cash flow and on the balance sheet.

Our free cash flow for the quarter was $174 million, up 12 percent from $155 million last year. We deployed $375 million in capital, with $248 million in M&A associated with Acea, returned $52 million to shareholders in dividends and purchased 1.1 million shares for $75 million. Lastly, we ended the quarter with $2.1 billion in cash and $1.8 billion in debt.

Now, let's turn to our non-GAAP financial guidance for the second quarter of 2019.

For Q2, we are expecting revenue to range from $1.255 billion to $1.270 billion, representing reported growth of 4.1 to 5.3 percent and core growth of 5 to 6 percent. Currency is estimated to be a headwind of 290 basis points, partially offset by M&A contributing roughly 200 to 220 basis points of growth.

Second-quarter 2019 non-GAAP earnings are expected to be in the range of $0.70 to $0.72 per share, which is 7.7 percent to 10.8 percent reported growth.

Based on the strong first quarter and updated exchange rates, we are also updating our full year guidance in both revenue and EPS.

We are updating our full year revenue guidance to a range of $5.15 billion to $5.19 billion, up $20 million on both the low and high end of the range and representing 4.8 percent to 5.6 percent reported growth. This reflects our Q1 performance as well as a benefit from our prior guidance associated with currency, although it is still roughly a 180 basis point headwind for the year. As a result, we are still expecting core revenue growth in line with 5 to 5.5 percent.

In addition, we are raising our full year earnings per share guidance to a range of $3.03 to $3.07, representing growth, excluding currency, of roughly 10 to 11 percent and reported growth of 8.6 percent to 10.0 percent, up a full point from previous guidance. Consistent with Q1, this is based on a 17 percent tax rate for the full year and full year average diluted shares of 322 million.

As we mentioned at the beginning of the year, this guidance includes both upsides and downsides, so I would encourage you to model at the midpoint of guidance at this stage.

Before opening the call for questions, let me conclude by saying we are very pleased with our Q1 results. Our start to the year and the continued hard work and focus of the Agilent team puts us in a strong position to achieve our goals for the year.

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