Agilent Technologies

Agilent Technologies Third Quarter Fiscal 2019 Conference Call Prepared Remarks

ANKUR DHINGRA

Thank you, and welcome everyone to Agilent's third 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 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, Ankur – and thanks everyone for joining our call today.

Our Q3 results exceeded our expectations. The Agilent team delivered total revenues of $1.27 billion, up 6 percent on a core basis. Our EPS of 76 cents is up 13 percent. Both our top line revenue and EPS are above the high-end of our guidance range. This marks our 18th consecutive quarter of adjusted operating margin expansion.

In July, we also announced the pending acquisition of BioTek, which would be our largest acquisition since the 2015 launch of the new Agilent. We continue to invest for growth even amid market uncertainty. At the same time, our Agile Agilent business system continues to drive operational improvements.

Our excellent overall company growth is being driven by two factors. First, strength in the global Pharma market, in both small molecule and BioPharma. Secondly, geographic strength in the U.S. across most end-market segments. China growth was generally in-line with expectations.

Business unit performance is led by double digit growth in our Agilent CrossLab and Diagnostics and Genomics groups. Let's take a closer look at the performance of all three of our business groups:

I will start with ACG, our Agilent CrossLab Group. The ACG business continued its trajectory of consistently strong results with 11 percent core growth. This growth was broad-based across all market segments and regions.

Our services business grew at a double-digit rate as we continue to see higher demand for our expanding portfolio – both from current and new customers. We see a continued secular trend of customers seeking to drive increased productivity and to outsource non-core services in the lab. Our services offerings put us in a leadership position to benefit from that trend.

Our consumables business also grew double digits. We continue to introduce highly differentiated consumables that address important customer challenges and significantly improve the user experience – especially in high growth markets like BioPharma.

I'm very pleased with the continued positive impact on total company results from Agilent's CrossLab strategy. Our consistent results speak to the strong execution from the Agilent team and the value we bring to our customers. We're meeting the ever-increasing demand from our customers and we see the attach rates to our installed base of instruments consistently improving.

Now turning to DGG, our Diagnostics and Genomics Group business. DGG's growth momentum continues with strong 13 percent core growth. The growth is broad-based across Pathology, Genomics and our NASD businesses.

Let me share a few additional comments on our NASD business. NASD turned in a very strong third quarter as we continue to see increasing demand from our customer's clinical trials. As a reminder, in June we opened our second production facility, located in Frederick, Colorado. We remain on-track to start commercial shipments this quarter.

We also announced that we purchased our previously leased site in Boulder, Colorado. These two facilities enable Agilent to meet the growing demand for development of RNA based therapeutics and continue to be a partner of choice to both pharmaceutical and biotech companies.

Now moving on to LSAG, our Life Sciences and Applied Markets Group. LSAG's revenue is flat year-over-year on a core basis and in line with our expectations. Strength in the Pharma, Environmental and Forensics markets was offset by Chemical and Energy declining against a very tough 12 percent compare and expected weakness in the China food market.

As you know, in Q2 we discussed three areas that impacted LSAG's growth rates. Let me give you an update.

First, starting with the 4+7 initiative in China, we saw sequential improvement in demand from generics manufacturers. This is driven by business coming from the winners of the first 4+7 pilot – resulting in growth in our instruments business. We have deep relationships and history with these customers. While the program is expected to expand over the rest of the calendar year, we see incremental regulatory clarity ultimately driving increased production volumes and a favorable long-term investment environment.

Second, the China Food market conditions remain the same as last quarter and in-line with our expectations with revenues flat to Q2. The business from government owned labs remains muted, while commercial testing labs activity is increasing. We are expecting similar overall market conditions this coming quarter as well.

Finally, the global small-molecule pharma business outside China saw improvement in demand relative to Q2. We saw budgets free up and LC replacements taking place in some of our large accounts as well as the addition of new customers.

While macro-economic and political conditions are creating market uncertainty for capital investments, I am quite confident in our ability to take market share – in whatever market environment we encounter. We have an industry leading portfolio and are not sitting still. We continue to invest in new offerings and markets.

One of these new market investments is the pending acquisition of BioTek. As I mentioned earlier, this quarter we announced our intent to acquire BioTek, a global leader in the design, manufacture and distribution of innovative cell analysis instrumentation.

I am very excited by this significant step forward in strengthening our leadership position in the fast-growing cell analysis space. Our strategic focus in this area began with the purchase of Seahorse Bioscience in 2015 and was followed by the acquisitions of Luxcel Biosciences and ACEA Biosciences in 2018.

By combining BioTek's offering with Agilent's, we will create a business with revenues of greater than $250 million per year -- up from zero four years ago. This business is growing double digits today. Looking ahead, we'll now be able to deliver a breadth of differentiated workflows, enabling customers to obtain deeper, more reliable insights across a variety of cell analysis applications. This is yet another example of how we're investing in new, high growth markets where we can leverage core Agilent capabilities and our One Agilent Culture.

The culture and portfolio fit with BioTek are extremely well- aligned. We share the same core values and have very similar cultures with a genuine focus on our customers and teams. I look forward to welcoming the BioTek team into the Agilent family. We expect the acquisition to close later this fiscal quarter.

We also continue to bring new and innovative offerings to the market across all of our businesses. These new offerings are consistently drawing very strong interest from both new and existing customers. For example, earlier this year, we launched major updates to our Gas Chromatography, Spectroscopy and Genomics portfolios.

In addition, in Q3, we had an excellent showing at the ASMS conference highlighted by the launch of the new Agilent InfinityLab LC/MSD iQ System. This new system incorporates 'designed-in' smart features, software, and hardware developed specifically for chemists and chromatographers. Our new LC/MSD iQ system is a single quad mass spec built on the revolutionary Ultivo LC-QQQ core technology platform. We also launched a brand-new Agilent 6546 LC-QTOF system that provides analysts ability to simultaneously acquire high-resolution data across an unprecedented dynamic range.

In addition, during the quarter we introduced a new Agilent 6495C Triple Quad LC/MS system – that provides industry leading precision in complex matrices. And finally, we introduced a new Agilent Bravo Sample Prep system for metabolomic analysis of human plasma samples. This new offering further strengthens our leading position in metabolomics.

We also brought to market the first outcome of our joint development work from the newly combined Agilent and ACEA teams. At the CYTO 2019 Congress, we introduced the Novocyte Advanteon Flow Cytometer. This new offering addresses today's high-end and increasingly sophisticated multi-color flow cytometry assays. It provides unsurpassed sensitivity, resolution, detection speed, and flexibility of fluorescent channels.

In addition, the number of indications for our PD-L1 diagnostic assay continue to expand. In Q3, we received FDA approval for two new indications. Our PD-L1 diagnostic may now be used as an aid in identifying patients for treatment with KEYTRUDA in a total of six cancer types.

While making all these investments and launching new products, we continued our trajectory of margin expansion – by 90 basis points versus last year. Our Agile Agilent system of continuous process improvement and disciplined cost management keeps the team focused on finding and executing on new opportunities.

A few closing comments on our Q3 results and company transformation that has been underway for several years.

Looking ahead, we continue to see uncertainty and a challenging market environment in some end-markets for capital instrument purchases. This quarter’s results again demonstrate Agilent’s on-going transformation toward higher growth markets and an increasingly resilient business model with a higher mix of recurring revenue streams.

Given our Q3 results and outlook, we’re raising our full-year guidance for earnings as well as revenue growth at the mid-point of guidance. Bob will describe this in more detail.

Before I turn it over to Bob, I'd like to leave you with a couple of thoughts. At the close of our Q2 call, I commented that great companies do not just react to market conditions, they see market opportunity.

At Agilent, we will continue to invest for growth and take market share, in whatever market conditions we encounter. We're continuing to drive productivity and we're doubling-down on our efforts to be a more agile company. We will continue to leverage our strong balance sheet to invest in the business and return capital to our shareholders. I'm quite confident that our company has never been stronger – and that we are well-positioned to drive continued growth and earnings expansion in an increasingly uncertain global economy.

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. In my remarks today, I will provide some additional detail on revenue, walk through the third quarter income statement and some other key financial metrics, and discuss our capital deployment during the quarter. I'll then finish up with our updated guidance for Q4 and the full year. Unless otherwise noted, my remarks will focus on non-GAAP results.

As Mike indicated, our third quarter results were very good as we had strong execution across a number of fronts. Revenue for the quarter was $1.27 billion, with core revenue growth of 6.2 percent. Reported growth was 5.8 percent. Currency negatively impacted revenue by 1.9 points and acquisitions added 1.5 points to growth.

In terms of end markets, Pharma, Diagnostics and Clinical, and Environment and Forensics, led the way for us in the third quarter.

Pharma, our largest end market, grew 13 percent. Strength was broad-based across instruments, services and consumables as well as NASD. Our BioPharma business continues to grow at a double digit rate, and we saw good growth in the small molecule business as well – both in instruments and recurring revenues.

Our Environmental and Forensics business grew 15 percent on a core-basis in the third quarter, albeit on an easier compare. As with the second quarter, our Forensics strength is tied to demand for expanded laboratory capabilities. This is a result of the ongoing global opioid crisis, which is driving increased sample testing and broader screening requirements.

Our Environmental business grew high-single digits, again driven by ongoing expansion of testing in China.

Diagnostics and Clinical core revenue grew 7 percent during the quarter – driven by the strength of our pathology and genomics businesses.

Chemical and Energy revenue grew 1 percent against a very tough compare of 12 percent growth from Q3 last year. Results were driven by continued strength in services and consumables. Academia and Government declined 5 percent largely due to order timing.

Concluding the discussion of end-markets, Food revenue declined 3 percent driven by China coming in as expected and as Mike discussed.

On a geographic basis, we again saw growth in all regions, led by the US growing at a double-digit rate, with strength across all three businesses. China grew 1 percent, generally in line with expectations primarily due to the weakness in Food. Excluding Food, growth in China was 6 percent. Asia, outside of China also grew at a double-digit rate, driven by growth in Japan and South Korea.

Europe grew 3 percent, in line with our expectations, as the macro environment remains subdued.

Now turning to the rest of the P&L, third quarter gross margin was 56.4 percent, essentially flat year-over-year, with tariffs impacting gross margins adversely by 30 basis points. We've been able to mitigate the impact of tariffs through disciplined cost management and the ongoing focus on efficiency.

Our operating margin was 22.8 percent, up 90 basis points as revenue growth outpaced growth in operating expenses. Year-to-date, our margins continue to expand as our teams have executed strong expense discipline. As a result, non-GAAP EPS for the quarter came in at 76 cents, 3 cents higher than the top end of our guidance and representing 13 percent growth.

In addition to our operating performance, we were very active in deploying capital during the quarter. In Q3, we returned $600 million to shareholders. We bought back shares worth $549 million, totaling 8 million shares and paid $51 million in dividends. We also signed a definitive agreement to acquire BioTek Instruments, for a cash price of $1.165 billion – and expect the deal to close by the end of our current fiscal fourth quarter.

So year-to-date, including BioTek, we have committed to deploying over $2.2 billion in capital. Of that, $1.4 billion was spent in acquisitions with ACEA and BioTek, expanding our cell analysis franchise. We have also returned over $800 million through dividends and share buybacks. Our balance sheet remains very healthy and we continue to look for opportunities to add growth assets to our portfolio.

Turning to Cash Flow, we generated $242 million in operating cash flow and ended the quarter in an effectively cash neutral position.

Now, let's turn to our non-GAAP financial guidance for the fiscal year.

As Mike indicated, with the strong results in Q3 and our outlook for the fourth quarter, we are raising our full year revenue and EPS guidance. Please note that our guidance does not include any impact from the expected closure of the BioTek acquisition.

For full-year revenue guidance, we're increasing the lower end of our range, thereby increasing the midpoint resulting in a new range of $5.105 billion to $5.125 billion, representing 3.9 percent to 4.3 percent reported growth. Currency is expected to be a headwind of 200 basis points partially offset by M&A contributing 150 basis points. As a result, we're now expecting core revenue growth in the range of 4.4 to 4.8 percent for the full year.

With the strong execution we've been seeing in terms of our business strategies, we're raising our full year earnings per share guidance range to $3.07 to $3.09. This represents growth of roughly 10.3 to 11.1 percent and reported growth of 10.0 to 10.8 percent. Also of note, the impact of the newly announced tariffs on the additional $300 billion of U.S. imports from China is not expected to be material for us.

And now, turning to the fourth quarter, we're expecting revenue in the range of $1.31 billion to $1.33 billion, representing reported growth of 1.2 to 2.8 percent and core growth of 1.5 to 3.0 percent. Currency is estimated to be a headwind of 100 basis points, partially offset by M&A contributing roughly 70 to 80 basis points of growth.

Fourth-quarter 2019 non-GAAP earnings are expected to be in the range of $0.84 to $0.86 per share, which is 3.7 percent to 6.2 percent reported growth versus a year ago. Also of note, the impact of newly announced tariffs on the additional $300 billion of U.S. imports from China is not expected to materials for us.

The share count for Q4 is expected to be 313 million.

Before opening up the call for questions, I'd like to conclude by saying that Agilent's resilient business model is built for the long term. We believe we are focused on the right strategies that will continue to serve us well and ensure solid shareholder value long into the future.

And with that, Ankur back to you for the Q&A.