Agilent Technologies First Quarter Fiscal 2020
Conference Call Prepared Remarks

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Thank you, and welcome everyone to Agilent's conference call for the first quarter of Fiscal Year 2020. 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 and Sam Raha, president of Agilent’s Diagnostics and Genomics Group. Due to certain personal engagements, Mark Doak, president of the Agilent CrossLab Group, is unable to join us today.

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. Revenue growth will be referred to on either reported or 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, Ankur – and thanks everyone for joining our call today.

I'd like to start today's call with a reminder that Mark Doak, ACG Group President will be retiring on May 1st. While Mark and his wife are currently enjoying a long-planned vacation and he is not able to join us today – I would be remiss in not taking the opportunity to recognize the outstanding accomplishments Mark has made in his stellar 38-year career. His track record of results speaks for itself. Thank you, Mark.

We have a very strong bench at Agilent and have already named Mark's successor, Padraig McDonnell. Padraig knows the business well. He has been on Mark's staff for several years and is currently running our Chemistries and Supplies division. Padraig and Mark are already working on transition activities as Padraig prepares to take the helm of the ACG business at the start of fiscal Q3.

Our congratulations to both Mark and Padraig – and now on to the quarterly results.

The Agilent team delivered a strong start to 2020. Q1 revenues are above our expectations as business grew in all regions and markets. Total revenues of $1.36 billion, are up 5.7 percent year-over-year on a reported basis and 2.4 percent on a core basis.

We continue to translate our top line growth into strong bottom line earnings. Our EPS of 81 cents is up 7 percent and is at the high-end of our guidance.

Before going into business unit and market details of our quarterly results, I want to speak about two specific areas that highlight how our "building and buying" strategy of investing in fast growing markets continues to deliver growth and helps us create a more resilient business.

First, I want to talk about our most recent acquisition, BioTek. This was the first full quarter with the BioTek team onboard, and the business is off to a very strong start with revenue growth above our expectations. We continue to be very enthusiastic about the cell analysis space and BioTek continues the strong momentum that originally got us interested in bringing them into Agilent.

The BioTek leadership team was just in Santa Clara for a few days of planning meetings – and they are very energized and excited about the future possibilities of making a great business even stronger, as part of Agilent.

Second, the resiliency of our business model is on full display this quarter – as Agilent delivered strong growth and earnings in the face of a negative Q1 impact from the coronavirus outbreak in China. As this has dominated headlines, let me add a few additional comments regarding the coronavirus and its impact on Agilent.

Most importantly, our thoughts go out to all those affected by the coronavirus. On the Agilent front, our team fortunately has not had any direct health impact, and many returned to work last week. We are remotely supporting our customers as a number of them gradually resume operations. We have also re-started our in-country production activities and are shipping product to customers within China and internationally, albeit at a reduced rate.

On the business side, given that our first quarter ended January 31st, we are seeing business impact across both fiscal quarters, Q1 and Q2.

In Q1, our revenues were running ahead of expectations right up to the Lunar New Year holiday. However, the extension of the Lunar New Year holiday affected our customers' ability to transact and accept shipments during the last days of the quarter. This reduced our reported revenue by approximately $10M in total for the quarter, primarily in our LSAG instrument business. We have since recognized the bulk of this revenue now in Q2.

Looking ahead, we are projecting that the coronavirus will continue to impact our China business throughout Q2. Bob will share additional details - but we are anticipating delays in new equipment purchases and slower uptake of consumables and services. The slower uptake is due to the reduced number of selling days resulting from the extension of the Lunar New Year along with customer and logistics operations that are ramping, but not yet fully operational.

It's important to note, while we're forecasting an impact to our Q2 business, our full-year outlook for total Agilent revenues and EPS remains unchanged. Our business outside of China remains on a solid footing and we believe a large portion of our China business that is currently being affected by the coronavirus is not lost but rather, is delayed.

As you know, the coronavirus outbreak is unfortunately impacting the health and safety of tens of thousands of people. I am very proud of how the Agilent team is responding to do our part to help. Our Agilent China team is actively supporting those customers doing crucial research into the virus. We have donated instruments and supplies to four clinical-and-research institutions based in China to support disease research and drug development efforts. We continue to closely monitor events in China and are prepared to act quickly to help wherever possible.

Now on to additional details of our quarterly results.

Agilent's growth is broad based – as our business grew across all regions and end-markets. Regional performance was led by the Americas posting 5 percent core growth with Europe coming in with low single digit results and Asia holding steady. Despite the timing of Lunar New Year and the coronavirus impact late in the quarter, our China business grew low single digits.

While all end-markets grew, our results were led by strong growth in the biopharma and environmental and forensics markets.

Now, taking a closer look at how the individual business units performed.

LSAG revenues grew 5 percent on reported basis, driven by strong performance in our biopharma and cell analysis businesses. On a core basis, LSAG revenues were down 2 percent against a tough compare and inclusive of the unexpected Q1 impact from the coronavirus. With the exception of China, all regions and end-markets performed in-line with expectations.

The ACG business continues to deliver strong results, posting 7 percent core growth even with reduced selling days in China. This growth was broad-based across all major market segments and regions. These results continue to demonstrate the strength of our CrossLab strategy and how we are leading the transformation of the analytical laboratory.

DGG is also posting 7 percent growth in the quarter, against a difficult 12 percent growth compare. We are experiencing a continuation of positive trends, winning share in our core pathology business and seeing strength in our NGS QA/QC franchise. We continue to be pleased with the revenue ramp at our new oligo manufacturing facility in Fredrick, Colorado.

In addition to driving strong financial results, I want to highlight some other notable events that took place during the quarter. We continue to bring differentiated new products to the market, gaining strong customer and external recognition. We just introduced the Agilent SureSelect XT HS2 DNA Kit. This, along with our recently launched automated sample prep platform, Magnis, further strengthens our leadership position in the NGS sample prep market.

In addition, two industry publications honored the Agilent InfinityLab LC/MSD iQ system with 2019 Innovation Awards. The award-winning mass spectrometer introduced last June incorporates intelligent “designed-in” innovations such as embedded sensors that monitor instrument health.

And finally, earlier this month, Barron’s named Agilent number one in their list of the 2019 Most Sustainable Companies in America. We’re very proud of this recognition. Sustainability is a critical topic that is gaining increased interest from customers, employees and investors. More importantly, we believe focusing on sustainability is simply the right thing to do.

Before passing the call on to Bob, I'd like to close with a reminder of Agilent's resilience and our shareholder value creation model – delivering above market growth, expanding operating margins and a balanced deployment of capital.

We are able to thrive by focusing on platforms with multiple large end-markets and long-term growth opportunities. We're also driving growth in the after-market, increasing our focus on faster-growing end-markets, streamlining our infrastructure and operations, and investing in the future of Agilent, both organically and inorganically. We do all of this while maintaining an acute focus on delivering EPS growth with superior quality of earnings and driving shareholder value creation.

Despite the temporary business uncertainty created by the coronavirus in China, I remain confident about the longer-term growth prospects of the China market, our China growth strategy and, most importantly, our team.

I am very proud and confident in the strength and resiliency of our China team – and their ability to overcome any near-term challenges that come our way. When I look at our global team and business, our growth prospects and team have never been stronger. We are laser focused on driving revenue and earnings growth. I'm pleased to tell you that all of these factors allow us to maintain our growth and earnings outlook for the year.

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 first quarter income statement and some other key financial metrics, and then finish up with our updated guidance for Q2 and the full year. Unless otherwise noted, my remarks will focus on non-GAAP results.

Our first quarter results were very good as we had strong execution across all regions and markets. Revenue for the quarter was $1.36 billion, with reported revenue growth of 5.7 percent. Currency negatively impacted revenue by 0.4 percentage points and acquisitions added 3.7 percentage points to growth. Core growth was 2.4 percent in quarter.

As Mike indicated, our performance was impacted by the extension of the Lunar New Year holiday due to the coronavirus. This reduced the number of shipping days in China and we estimate shifted $10 million in revenue out of Q1. If not for the reduced shipping days in Q1, our performance would have been stronger, with the shift affecting our core revenue growth by roughly 70 basis points.

In terms of end markets, we saw growth across all of our six end market segments. Pharma, Environment and Forensics, and Diagnostics and Clinical led the way for us in the first quarter.

During the quarter, Pharma grew 3 percent. Double-digit growth in DGG and high-single digit growth in ACG offset a mid-single digit decline for LSAG. Within Pharma, our Biopharma, or large molecule segment, grew high-single digits. On a geographic basis, our pharma business experienced high-single digit growth in the Americas and mid-single digit growth in Europe. This was partially offset by a mid-single digit decline in China largely associated with the timing of the Lunar New Year and to a lesser extent, the execution the “4+7” program.

The “4+7” program is playing out as we expected, with the third round completed in January and multiple winners per drug. We continue to believe this is a long term positive for the industry as drug quality improves and access to healthcare increases.

Our Environmental and Forensics business grew 4 percent against a very tough compare last year of 10 percent. During the quarter we saw balanced growth between instruments and aftermarket sales.

Diagnostics and Clinical revenue grew 3 percent against a strong 11 percent compare last year. Mid-single digit growth in DGG driven by continued share gains in our pathology business were partially offset by declines in LSAG and ACG – with both having only small businesses in this segment.

Chemical and Energy revenue grew 2 percent. Services and consumables grew mid-single digits, offset by flat Instrument sales.

Academia and Government grew 1 percent with services and consumables growing mid-single digits partially offset by flat instrument sales. Mid-single digit growth in the Americas was partially offset by flat to low-single digit declines in other regions.

Finally, Food returned to modest growth, up 1 percent. Low-teens growth in services and consumables was partially offset by declines in instrumentation. While one quarter doesn’t make a trend, we are pleased with the continual progress in this market.

On a geographic basis, we saw growth in all regions, led by the Americas growing mid-single digits.

Europe grew 2 percent, in line with our expectations.

As Mike indicated, our business in China was running ahead of expectations through the first two months of fiscal 2020. As mentioned earlier, despite the shift of the $10 million, China still grew one percent. If not for the extension of the Lunar New Year, our core growth in China would have been solidly mid-single digits.

Now let’s turn to the rest of the P&L.

Gross Margin was 55.7 percent, down 120 basis points versus the prior year. This is a result of planned startup costs for our new NASD facility as well as product mix and some negative pricing effects on our instrumentation business. We offset 90 basis points as we leveraged our cost basis in operating expenses. As a result, our operating margin was 22.9 percent, down slightly from 23.1 percent in the first quarter of last year.

Adjusting for the $10 million coronavirus impact on revenue, operating margins would have increased versus the prior year and so we feel good about our continued opportunity to expand operating margins. We also were able to lower our tax rate slightly to 15.5 percent and expect that rate to continue for the rest of the year.

This resulted in non-GAAP EPS for the quarter coming in at 81 cents, at the top end of our guidance and representing 7 percent growth.

Before turning to second quarter guidance, I want to touch on a few other financial metrics.

Our operating cash flow was an outflow of $59 million, in line with expectations as we incurred the one-time tax outflow of $226 million related to transfer of intangibles as noted last quarter. We also paid out $56 million in dividends and purchased 726,000 shares for $60 million. We ended the quarter in a net debt position and a net leverage ratio of 0.9 times.

Now, let’s turn to our non-GAAP financial guidance for Q2.

We are anticipating revenues in the range of $1.28 billion to $1.32 billion in the second quarter. This range is larger than we’ve traditionally provided as we have attempted to estimate an impact of the coronavirus on our business in the second quarter.

As this is a fluid situation, we thought it would be helpful to detail out our assumptions, particularly as we've seen the impact across both Q1 and Q2. Our guidance contemplates a $25 million to $50 million impact in our first half of our fiscal year, which translates roughly to a one and a half to three-week impact on China revenues. Of this, we saw $10 million in Q1 and we are estimating a net $15 to $40 million incremental impact in Q2.

The Q2 revenue range of $1.28 billion to $1.32 billion translates into reported growth of 3.4 to 6.6 percent with core growth of 1 to 4 percent. Currency is expected to have a negative 1.1 percent impact while M&A is expected to contribute 3.5 to 3.7 percent in the quarter. We are estimating the coronavirus to negatively impact our Q2 growth by 1 to 3 points. Our revenue outlook translates to Q2 earnings in the range of 72 cents to 76 cents per share, or 1.4 percent to 7.0 percent growth versus last year.

Importantly as Mike mentioned, we believe the majority of this business is not lost, rather delayed as customers and the government ramp and recover. In addition, our business outside of China remains strong. As such, we expect a larger second half of the year and are not changing our full year guidance for revenue or EPS.

So before opening up the call for questions, I want to conclude by saying we had a very solid start to the year, that shows the strength and breadth of our portfolio. It is that portfolio, coupled with the strength of the Agilent team that despite uncertainty caused by the coronavirus, we are maintaining our full year outlook.

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