Agilent Technologies

Agilent Technologies Second Quarter Fiscal 2020 Conference Call Prepared Remarks

ANKUR DHINGRA

Thank you, and welcome everyone to Agilent's conference call for the second quarter of Fiscal Year 2020. I hope that all of you and your families are safe and healthy.

On the webcast today are Mike McMullen, Agilent's president and CEO, and Bob McMahon, Agilent's senior vice president and CFO.

Joining for the Q&A after prepared remarks 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, along with Padraig McDonnell, 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 and revenue growth will be referred to on a core basis. Core revenue growth excludes the impact of currency and the acquisitions and divestitures completed within the past 12 months.

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 want to add my best wishes as well - and hope that you and your families are safe and healthy.

I'm pleased to have Padraig McDonnel, our president of the Agilent CrossLab Group joining us for the first time today. As I mentioned last quarter, Mark Doak has retired from the company and Padraig is now leading ACG. I know you will enjoy getting to know Padraig better in his new role and I'm glad he can be here with us on the call.

Last quarter, Agilent was among the first to discuss the business impacts of COVID-19. Since then, much has changed as COVID-19 is now a global pandemic. The world is a very different place than it was back in February.

What hasn't changed is the attitude and execution of the Agilent team and our unwavering focus in four key areas.

Let me first talk about how we are protecting our people. Our top priority is ensuring the health and safety of the Agilent team. Early on we instituted a global "work from home" policy and severely restricted travel. We implemented new work practices and safety protocols for our manufacturing teams and service engineers visiting customer laboratories.

The team is really stepping up. True to the Agilent mission, our response to COVID-19 is driven by our commitment to our people and our customers.

It should be no surprise then that our second area of focus is an unwavering commitment to our customers. We are – and have been – open for business. From the early stages of the pandemic, we took decisive action to secure our global business operations.

We are using innovative and more efficient ways to support our customers – from leveraging our digital capabilities for remote technical assistance, to urgently delivering Bravo Liquid Handler systems for their COVID-19 tests, or providing "live" online guidance to keep labs functioning – we're doubling down on efforts to support our customers. This is especially true as their needs change and evolve.

Our third focus area is taking quick and decisive action to preserve a strong P&L and balance sheet. When we experienced significant disruption to business activity in late March, we made changes in our supply chain, logistics and business operations. This ensured continuity of order in-take and our ability to deliver products and services to our customers.

We also didn't shy away from taking swift action to reduce expenses. We quickly put in-place a cost management program while re-prioritizing and sustaining our growth investments. As we continue to sharpen our plans, we will not put our future growth opportunities at risk.

Bob will share more details, but a top priority is monitoring our liquidity and cash flow. We have taken actions to ensure a strong balance sheet and financial flexibility.

The positive impact of our approach shows in our Q2 results. In the midst of the spread of the global pandemic, the Agilent team delivered Q2 revenues of $1.24 billion. This is flat on a reported basis and down a little less than 2 percent on a core basis. Our Q2 operating margins of 22.4 percent are up 50 basis points. We posted earnings per share of 71 cents during the quarter – flat versus our results a year ago.

Before covering additional Q2 detail, a few comments on our fourth key area of focus – our continued prioritization on growth. Our "building and buying" growth strategy remains firmly in place, while we are taking decisive action on our cost structure to respond to the COVID-19 impact. We are continuing to prioritize investments in fast growing markets, such as biopharma, that deliver incremental growth and help us create a more resilient business. When we all come out of this on the other side, Agilent will be poised for growth.

Our Q2 pharma growth is being driven by the strength of our strategy in action. This is a direct result of our "building and buying" strategy in the biopharma space. Our approach to investing for growth continues to serve us well and will be a major factor in helping us emerge from the current environment stronger than ever.

An example of our approach to continually assessing our growth investments is the decision we've made regarding our cancer diagnostics strategy and the Lasergen sequencer development program.

Given changes in the marketplace, we believe we can now capture future growth in the NGS diagnostics space without the need for our own sequencer platform. As a result, we've made the decision to shutter our sequencer development program. We are re-directing our investments with the valuable intellectual property we've created into areas of higher interest. Despite this program change, we remain optimistic about continued growth in NGS cancer diagnostics.

Let's now take a closer look at the quarter as well as the future outlook in today's COVID-19 world.

Last quarter, our attention and revised outlook was focused on our China team, customers and business. As COVID-19 spread to other parts of the world in the second quarter, the situation changed. During February and March our overall business was up about one percent. However, in late March, we faced significant disruption in business activity as Europe and the Americas restricted access to facilities.

Our China business is recovering better than forecasted. We posted 4 percent core growth in China, with increasing strength throughout the quarter. In fact, in April China posted strong growth while all other geographies experienced declines.

We expect the China growth recovery to continue throughout the year, as lab operations and investment continue to resume. The near-term outlook in Europe and the U.S., however, remains challenging – particularly for new equipment purchases across most end-markets and non COVID-19 diagnostic testing.

Some quick highlights across our businesses. Both DGG and ACG delivered core growth. DGG's 5 percent growth is driven by NASD up 35 percent as the ramp of that business continues as planned. ACG was up 1 percent. Our LSAG business declined 7 percent as customers curtailed equipment purchases, although we did have pockets of growth in bio pharma, cell analysis, and COVID-19 testing and research.

From an end market perspective, Pharma grew 5 percent in the quarter, followed by 4 percent growth in Diagnostics and Clinical. The Food market continued its recovery with a modest 1 percent growth driven by China. Our Environmental and Forensics business is down 1 percent for the quarter

In Q2, Academia and Chemical and Energy are the end markets that are most impacted, down 16 percent and 10 percent, respectively. We expect continued pressure in these markets throughout the rest of the year, although we are seeing some pockets of growth in chemical production regionally, as some customers shift supply chains.

Looking forward, we expect Q3 to be the most challenging quarter of the year with gradual improvement during the course of the quarter and continuing into Q4.

As a key player in the life sciences industry, Agilent also has an important role to play in the fight against COVID-19. Before closing, I'd like to share a few thoughts on our COVID-19 offerings.

While the COVID-19 virus is negatively affecting our overall growth at this time, Agilent is supporting several aspects of COVID-19 research and testing along with therapeutic and vaccine development. In Q2, this resulted in a one point “tailwind” of growth, primarily in providing instrumentation.

There is potential that this will become a more meaningful “tailwind” in future quarters. To address this, we have mobilized a cross-Agilent team to maximize support to customers around the globe fighting the virus. These offerings range from instrumentation, such as automation, PCR and microplate testing, to consumables and components necessary for testing, as well as lab support to these customers.

As we enter Q3, I want you to know that the global Agilent team is energized and remains focused on supporting our customers and driving growth. We have taken swift and decisive actions to ensure a continued strong P&L and balance sheet. We remain a diversified, resilient company with a bias for speed, execution and growth.

Thank you for being on the call. I will have a few closing comments after Bob speaks and then we look forward to taking your questions. And now, Bob you’re up.

BOB MCMAHON

Thank you, Mike and good afternoon, everyone.

Before I begin, I want to repeat what Mike and Ankur said in hoping you are all doing well and staying safe. Looking forward, I for one, am confident we will get through this and I look forward to the day when we can follow up these calls with face-to-face meetings again.

In my remarks today, I will provide some additional detail on revenue, walk through the second quarter income statement and some other key financial metrics, and then finish up with a framework for thinking about Q3.

Given the current volatility and uncertainty that exists, we are not going to provide specific forward-looking guidance today. That said, in the spirit of trying to be helpful and transparent, we will provide a glimpse into the evolution of our business during the second quarter and our thought process on how things may play out in the coming quarter. Unless otherwise noted, my remarks will focus on non-GAAP results.

Reported revenue for the quarter was $1.24 billion, which was flat versus last year on a reported basis. Currency negatively impacted revenue by 1.6 percentage points and acquisitions added 3.3 percentage points to growth. On a core basis, revenue declined 1.7 percent in the quarter.

The pacing of revenue during the quarter varied significantly by region – driven by where each region was in the cycle of precautionary measures being taken to slow the spread of the virus.

As we previously disclosed, we saw overall business activity slow in late March driven by the US and Europe. The stay-at-home measures in those regions reduced lab operations and limited lab access and our ability to install equipment. This lower level of business activity carried through the month of April resulting in double digit declines for the month in these regions.

On the other hand, and as we had anticipated, business activity picked up throughout the quarter in China as restrictions were slowly lifted. We saw strong growth in China in April, partially due to catch-up from lower business volumes in February and March. Overall, China grew 4 percent core for the quarter, exceeding our initial expectations at the start of Q2.

In total for Q2, quarter-to-date results through March were up 1 percent, while April was down roughly 6 1/2 percent, resulting in the 1.7 percent core decline.

Before getting into some additional group details, it’s also important to note that while we have seen order pushouts, we have not seen increased order cancellations. While there is always some level of cancellation, in both March and April, cancellations were lower than the previous year.

Our resilient business model was extremely important to us as we navigated the effects of a challenging environment. As Mike mentioned, DGG and ACG both grew on a core basis, while the LSAG instruments business declined.

LSAG declined 7 percent core in the quarter but saw some bright spots with growth in large molecule pharma, cell analysis and COVID19 testing and research In addition, as Mike mentioned, we had modest growth in the food market.

For LSAG, the impact of COVID-19 related closures was most pronounced in the academia and government, and chemical and energy markets.

ACG grew 1 percent with China growing in the high single digits. Our ACG results were negatively affected by delays in installations and lab closures in Europe and the Americas during the quarter.

I'm pleased to say that our DGG business delivered 5 percent growth during Q2 and was on track for double digit growth, prior to the slowdown in the US and Europe. We saw sequential growth in genomics, boosted by products used to develop testing capabilities and for vaccine research into COVID-19. Our NASD ramp remains on track and delivered excellent growth this quarter as well. The pathology business grew in all regions, except the U.S., where the effect of delays in non-COVID-19 related medical procedures was more pronounced in April.

On a geographic basis, all regions ranged from flat to down 4 percent for the quarter, with Europe down 4 percent, Americas down 1 percent and Asia Pacific, flat. Within Asia, China grew four percent as we've discussed.

Now let's turn to the rest of the P&L. As the expanded impact of the pandemic became apparent, we moved quickly and decisively to adjust our cost structure through targeted discretionary spending program reductions. We continued to invest in our key growth opportunities and important capabilities, such as digital. For example, we leveraged digital and virtual reality investments for our field service engineers to continue to support our customers where we did not have physical access.

While we took actions across the P&L, we focused most of our effort on SG&A. R&D investments, as a percentage of revenue, were largely unchanged from the prior year.

As a result, operating margins of 22.4 percent improved 50 basis points over last year on flat revenue. Gross Margin, at 55.4 percent, was down 60 basis points versus the prior year mostly due to volume and the revenue mix shifting more toward services. In addition, we saw higher logistics costs as moving goods internationally became more expensive.

This combination of factors resulted in non-GAAP EPS for the quarter coming in at 71 cents per share, flat with the number we posted a year ago.

In terms of the balance sheet, we were in the market early in the quarter repurchasing 1.66 million shares for $126 million. In late March, however, we suspended all share repurchases to maximize our liquidity and financial position. While not in our current plans for Q3, we continue to monitor and evaluate when repurchases will resume.

We generated $313 million in operating cash flow during the quarter, which is a $61 million improvement over last year, despite building some raw material inventory to assure supply. Additionally, we've taken steps to reduce our capital spending by roughly one-third.

We ended the quarter in a strong position with $2.1 billion in available liquidity, including $1.3 billion in cash and roughly $800 million available under our revolving credit facility. Our net leverage ratio, defined as net debt to EBITDA was 0.9 times.

Given our cash flows and strong financial position, there is no change to our dividend.

As you may recall we withdrew our 2020 guidance in mid-April due to uncertainty surrounding the duration and severity of the global COVID-19 pandemic and the impact on the global economic environment. While various countries have started working toward re-opening, the pace and effect of global reopening efforts is still unknown and so we won't be providing guidance for Q3 or the full year. However, we did want to provide a framework and a range of possibilities for how our business could unfold in the coming quarter.

When we look at Q3, we expect May to be very similar to April and the business activity we've seen in the first weeks of the month confirm that view. We anticipate that China will remain ahead of the curve in terms of economic recovery relative to the rest of the world.

We expect Pharma, and our services, particularly contracted services, which make up the majority of service revenue, to remain resilient. We will also be following the consumables business very closely to monitor early signs of recovery in demand patterns.

A combination of these factors could result in our revenues being down between 5 percent to 15 percent on a core basis.

At the lower end of the decline, we assume activity in June and July will continue to improve, with the COVID-19 offerings Mike mentioned having a more significant impact than the 1 percent contribution in Q2.

On the higher end of the decline, we're building in the assumption that there would be no significant improvement throughout the course of the quarter in the US and Europe, that non-COVID-19 testing would not recover, and China would plateau.

While this is a wide range, there is still significant uncertainty in the pace of recovery as the US and Europe are currently lifting restrictions. We hope that the 15 percent decline proves very conservative but wanted to provide you with some of the assumptions we are using to manage going forward. In Q3, we expect a 2-point headwind due to exchange rates, while M&A should be a 3-point tailwind.

Again, this is not formal guidance, but should give you a sense for some of the variables we are looking at within the business and believe this is the best way to view the third quarter given the uncertainties that exist. As Mike said, we also believe that Q3 will be the most difficult of our fiscal year as the world works through reopening the economy.

Overall, I feel we are very well positioned to deal with this challenging environment, accelerate market share gains and come out even stronger as the global economy recovers.

Before I turn the call back over to Mike, I want to conclude by saying Agilent's performance through two quarters truly shows the resiliency of our company. I also want to thank the Agilent team for remaining focused on supporting our customers during this time. And, I'd be remiss without a shout out to the Finance team for being able to close the books in such a professional manner with everyone working from home.

We've taken the actions that will serve us incredibly well through the rest of 2020 and into the future. And with that, I believe Mike would like to share some final thoughts before we move on to the Q&A. Mike?

<u>MIKE MCMULLEN</u>

Thanks Bob. Before we take your questions, I want to close by saying that I couldn't be more proud of our Agilent team. The idea that difficult situations provide the opportunity for organizations and individuals to step up and exhibit strength, leadership and resiliency has never been more true at Agilent.

The Agilent team has been tested during this crisis like no other time -- and they have not shied away from it. Instead we have answered the call with world class execution, an even stronger focus on customer service and an inspired creativity that is second to none.

I am absolutely convinced we will emerge from this pandemic as an even stronger force in the marketplace. And, with that, I will turn things over to Ankur so we can take your questions. Thank you.