Agilent Technologies

Agilent Technologies Third Quarter Fiscal 2020 Conference Call Prepared Remarks

ANKUR DHINGRA

Thank you, and welcome everyone to Agilent's conference call for the third 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 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 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.

The Agilent team delivered excellent results in the third quarter in the midst of a historic global pandemic. Against this backdrop, Agilent’s performance once again highlights the strength and resiliency of our team… and our business.

Agilent’s Q3 revenues are $1.26 billion. Our revenues are down just 1 percent on a reported basis despite COVID-19 headwinds, in what we expect to be the year’s most challenging quarter. On a core basis, revenues are down 3 percent. These results demonstrate the strong resilience we have built into our business over the past several years.

EPS is 78 cents per share. This is a 3 percent year-over-year increase. Operating margins improved 90 basis points over last year to 23.7 percent. Our Q3 results are further evidence of the success of our profitable “build and buy” growth strategy. We continue to build a more resilient, growth-oriented business.

Last quarter I talked with you about the four key priorities we’re focused on during the COVID-19 pandemic -- protecting our people, being open for business for our customers, taking decisive actions to preserve our P&L and balance sheet, and an unwavering commitment to growth. Staying focused on these priorities has helped us navigate through the COVID-19 effects on our team, customers and business.

Our customers continue to respond very favorably to our team’s engagement and our enhanced digital capabilities. In fact, Q3 customer satisfaction rankings are at all-time highs.

In all regions, we're seeing improvements in lab access for our customers and increased non-COVID-19 testing volumes. There are, however, regional and end-market differences in the pacing of improvement.

Lab access improved through the quarter, although still not at pre-COVID-19 levels. Globally, lab access remains limited in academia non-COVID-19 research and teaching labs. We are also seeing continued limited access to some private sector research labs in Europe and the United States.

Similarly, non-COVID-19 diagnostic testing volumes improved through the quarter but remain down from prior year levels. Hospital access in Europe and the U.S. is improving, although disrupted at times by virus flareups.

While there are indications of improvement in economic growth at varying degrees across the globe, caution remains in customer capital expenditure decisions. Consistent with our thinking coming into the quarter, the pacing of recovery varied by region. As expected, China led the way for us and exceeded our expectations with revenues up 11 percent. China's growth in the quarter is broad-based, across all end-markets and for all business groups.

While improving, the rate of recovery in Europe and the Americas lags China given the timing of when these regions first felt the brunt of the pandemic. European revenues are down 5 percent.

Americas' market conditions trail both China and Europe, with revenues declining 10 percent. However, as we exited the quarter, we are seeing signs of improvement in service activity, consumables and diagnostic testing volumes. On a total company basis, we exited July with modest growth across all major markets.

Now, let's talk about our performance by business group.

Our Life Sciences and Applied Markets Group grew 2 percent on a reported basis and declined 4 percent core. Our team is focused and determined to gain market share, despite a constrained capital environment. The strength of our portfolio coupled with an energized and stable sales team is paying dividends. I am also very proud of the contributions our cell analysis technologies are making in COVID-19 virus research. Our M&A strategy is working and making a difference in the pandemic fight.

Our CrossLab Group revenues grew 1 percent. Increases in customer activity led to increased sales of consumables and an uptake of on-demand services. The CrossLab team continues to win large multi-year contracts for enterprise laboratory management that will benefit us moving forward. We are continually increasing our competitiveness in this space.

Our Diagnostics and Genomics Group revenues declined 8 percent. While our overall pathology and genomics businesses are down for the quarter, we did see gradual improvement in diagnostic testing volumes and non-COVID-19 lab openings. Partially offsetting this, our Nucleic Acid Solutions business delivered another strong quarter, growing almost 25 percent.

We are very excited about the future of our NASD business. As we announced earlier today, we plan to more than double oligo manufacturing capacity at our new Frederick, Colorado site. This expansion helps us meet significantly increasing customer demand. We are growing double-digits and expect to continue at this rate of growth in the coming years.

We continue to invest in our portfolio across all our businesses. Highlights during the quarter include LSAG launching two new LC-Mass-Spec products -- the Agilent 6470B Triple Quad and the Agilent RapidFire 400 system. Both products are aimed at high-throughput labs, driving productivity and superior resolution.

We launched our CrossLab Asset Monitoring service, which is a new subscription service, using instrument-sensor technologies to provide data driven usage insights. This helps drive improved customer economics and lab productivity. While early, we are seeing strong interest from customers in this service.

During the quarter, our PDL-1 assay was approved by the FDA for expanded use in non-small cell lung cancer – helping guide physicians in selecting treatment using specific immunotherapies.

Our team is very proud of the role their company is playing in the global COVID-19 fight. We are supporting COVID-19 research, testing, and therapeutic and vaccine development. Our efforts in the global fight against the virus delivered two percentage points of reported growth. We are accelerating efforts to make a difference in the battle against COVID-19 and have mobilized a cross-Agilent team to maximize customer support.

Let me close with a few comments on our outlook in the coming quarter. While there is still significant uncertainty regarding the continued pace of recovery, we expect the July trend of gradual improvement in our business to continue into Q4.

By region, China will continue to be a positive story for us and lead the return to growth. Europe is starting to trend upward. The Americas are also expected to improve, but at a lower rate than China and Europe. Globally, improved lab access, increasing non-COVID-19 testing and a slowly recovering global economy are all positive signs.

I remain absolutely convinced Agilent will emerge from this pandemic with a stronger position in the marketplace. Our continued focused actions on our four priorities – protect the team, support our customers, preserve our P&L and balance sheet, and our unwavering investment in growth – are delivering.

Entering Q4, we are operating from a position of strength and with momentum. Yes, this pandemic remains unpredictable. However, I am cautiously optimistic about our continued gradual recovery and return to growth.

Before I hand the call over to Bob, I'd like to pause and share my hope that you and your loved ones are staying safe and healthy. Thank you for being on the call. I look forward to taking your questions after Bob's remarks. And now, Bob over to you.

<u>BOB MCMAHON</u>

Thank you, Mike and good afternoon, everyone.

Today I will provide some additional detail on revenue, walk through the third quarter income statement and some other key financial metrics, and then finish up with a framework for thinking about Q4.

As with last quarter, there are still too many unknowns, so we are not going to provide formal, forward-looking guidance today. However, we will provide a framework for how we see things potentially playing out in Q4. Unless otherwise noted, my remarks will focus on non-GAAP results.

As Mike mentioned, our revenue for the quarter was $1.26 billion, down 1 percent on a reported basis. On a core basis, revenue declined 3.1 percent in the quarter. Currency negatively affected revenue by 1.3 percentage points while acquisitions added 3.4 percentage points to growth.

As Mike talked about the regional performance, I will speak to end market performance.

In terms of our end markets, Pharma grew two percent in Q3 against a very strong comparison of 13 percent from last year. Both small and large molecule applications grew, and Biopharma improved throughout the quarter as drug development labs increased production and access.

We experienced softness in Diagnostics and Clinical, as anticipated. Revenues declined 10 percent, primarily due to conditions in the U.S. driven by COVID-19 related disruptions to patient visits and diagnostics lab opportunities. Encouragingly, we did see an improvement in routine testing throughout the quarter, especially in China and Europe, while the U.S. lagged.

Chemical and Energy, was down 10 percent, consistent with our thinking. Revenues were generally flat sequentially with conditions largely similar to what we saw in Q2. As we have talked about previously, we expect this segment to ramp back more slowly than others.

The Food segment was a bright spot, up 8 percent. We are seeing ongoing signals that the market in China has stabilized with the transition of more testing by commercial labs. The food market was just one of several bright spots that contributed to double digit growth in China, including growth in the low teens for our pharma business.

Our Environmental and Forensics business declined mid-single digits against a double-digit comparison.

The Academic and Government segment declined mid-single digits and improved on a sequential basis in Q3. Strength in cell analysis and liquid handling for viral research partially offset the widespread impact of ongoing academic lab closures.

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

I’m extremely proud of how the Agilent team has responded to the challenging environment. During the quarter we continued our focus on managing expenses, while ensuring we continue to invest in our key growth opportunities. The expense management actions we initiated last quarter were on full display this quarter. In addition, our customer engagement model using digital tools continued to gain traction, while also delivering savings in SG&A.

As a result, operating margins of 23.7 percent improved 90 basis points over last year on declining revenue. Gross margin, at 55.1 percent, was down 130 basis points versus the prior year, largely due to mix and higher logistics costs. However, strong cost management in operating expenses more than offset the decline in gross margin.

This combination of factors resulted in non-GAAP EPS for the quarter coming in at 78 cents per share, up nearly 3 percent from the number we posted a year ago.

From a balance sheet perspective, we generated $290 million in operating cash flow during the quarter, which is a $48 million improvement over last year. In terms of capital spending, we spent $25 million, lower than last year and in line with our revised outlook in Q2. We ended the quarter in a strong position with $2.3 billion in available liquidity, including $1.36 billion in cash.

Also during the quarter, we took also took advantage of low interest rates and refinanced half a billion dollars in short term debt with a 10-year bond with a 2.1 percent coupon, the lowest coupon in our portfolio.

As you know we paused share buybacks in Q2 pending improvement in business conditions. In Q3, our visibility into business trends and cash flow improved and we resumed anti-dilutive share repurchases late in the quarter. In total for the quarter, we repurchased 360,000 shares for $33 million.

Going forward, we intend to resume our normal pattern of regular anti-dilutive repurchases along with additional opportunistic buying. Our overall capital deployment approach remains balanced with the primary focus on growth M&A opportunities, while also returning cash to shareholders via dividends and buybacks.

As we look to Q4, business trends have gradually improved, but significant uncertainty remains around the evolution of this pandemic. However, let me provide a framework for how we see a range of possible revenue growth scenarios in the coming quarter.

We generally expect the trajectory of gradual improvement in business results to continue across all regions. Areas where we see a broader range of scenarios include research spending, both in academia and other markets, non-COVID diagnostic testing, especially in US, and in the general capex environment.

A combination of these factors could result in scenarios where our revenue performance could range from a 4 percent decline to 1 percent core growth. Also as a reminder, the BioTek acquisition closed mid-way through Q4 of last year, so the M&A impact in Q4 will be smaller than in previous quarters, roughly 1 point of growth and currency is forecasted to be positive in the quarter.

The low end of the range envisions COVID-19 flare-ups occurring in the fall in various geographies, limiting and in some cases, reversing the recovery gains we have seen for a period of time. In this scenario one might expect to see slower or stalled improvements in research, academia and other markets as well as continued tight cash-management leading to lower capex spending in the US and Europe. We hope this bottom end of the range is overly conservative, but we wanted to let you know we have plans in place in case this happens.

The higher end of the range assumes the continued recovery by region building on what we have seen in July, with the biggest impact coming from the US. This would include a continual increase in elective medical procedures, such as cancer screenings and continued lab openings. This view would include continued China momentum, along with continued improvement in Europe and other areas in the Americas.

Again, this is not guidance, but should provide a sense for some of the variables we see for Q4.

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 continues its path to recovery.

And with that, I will turn things over to Ankur to direct the Q&A. Ankur?

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