Agilent Technologies

Agilent Technologies Second Quarter Fiscal 2022 Conference Call Prepared Remarks

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Thank you Salena, and welcome everyone to Agilent's Conference Call for the second quarter of Fiscal Year 2022. With me are Mike McMullen, Agilent president and CEO, and Bob McMahon, Agilent senior vice president and CFO.

Joining in the Q&A after Mike and Bob's comments will be Jacob Thaysen, president of the Agilent Life Science and Applied Markets Group; Sam Raha, president of the Agilent Diagnostics and Genomics Group; and Padraig McDonnell, president of the Agilent CrossLab Group.

This presentation is being webcast live. The news release for our second quarter financial results, investor presentation and information to supplement today's discussion, along with a recording of this webcast, are available on our website at http://www.investor.agilent.com

Today's comments by Mike and Bob will refer to non-GAAP financial measures. You'll 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 references to revenue growth are on a core basis. Core revenue growth excludes the impact of currency, and any acquisitions and divestitures completed within the past 12 months. Guidance is based on exchange rates as of April 30.

As previously announced, beginning in the first quarter of Fiscal 2022, we implemented certain changes to our segment reporting structure. We have recast our historical segment information to reflect these changes. These changes have no impact on our company's consolidated financial statements.

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, Parmeet. And thanks to everyone for joining our call today.

In Q2, the Agilent team again demonstrated the resilience and strength of our business model. We delivered core revenue growth in-line with our forecast, expanded operating margins, and exceeded our EPS expectations. We did this while navigating a dynamic macro environment, including the conflict in Ukraine and COVID-related lockdowns in China.

Our Q2 revenues are $1.61 billion. This is up 7 percent core and is on top of growing 19 percent in Q2 a year ago. Order performance was even stronger, growing double digits on a core basis.

Second quarter operating margins at 25.3 percent continue to expand, up 140 basis points from last year.

Earnings per share of $1.13 are up 16 percent.

We achieved these results despite the COVID-related lockdowns that closed our operations in Shanghai, starting in late March and continuing through the entire month of April. We estimate that this was roughly a 350-basis point headwind to our core revenue growth for the quarter. As Bob will indicate when he takes you through the details, this business is not lost and is expected to be recovered through the rest of the calendar year.

Most importantly, our team in China is safe and we restarted limited operations in May at our GC factory and logistics center in Shanghai.

From an end-market perspective, the pharma and chemical and energy markets again led the way for us. Our pharma business, Agilent's largest market, grew 13 percent, led by biopharma growing high "20s." This represents our seventh consecutive quarter of double-digit growth in the Pharma market. It also builds on top of a stellar 29 percent growth rate last year.

The momentum in our chemical and energy business also continued this quarter, delivering 9 percent growth in line with expectations, and overcoming the shutdown of our primary GC production facility in Shanghai and the conflict in Ukraine. Growth was driven by advanced materials and chemicals.

On a geographic basis, the Americas again led the way with 13 percent growth built on top of 27 percent growth a year ago. Europe also performed well with growth coming in at 7 percent following 16 percent growth last year.

China revenues were on track with our expectations through March, but we exited the quarter down 3 percent given the COVID-related lockdowns.

While revenues were affected by the temporary shutdowns in the quarter, overall demand in China remains very robust. In fact, China was the fastest growing region in Q2 from an order perspective, up about 20 percent.

We remain very confident about the ongoing strength of our business in China.

Looking at our performance by business unit, the **Life Sciences and Applied Markets Group** generated revenue of $896 million, an increase of 4 percent on a core basis. Given our manufacturing footprint and relative strength in China, LSAG was disproportionately impacted by the COVID related shutdowns there.

To provide some additional perspective, all major product lines, excluding GC related products, grew solidly in the quarter, led by strong performance in our cell analysis business growing in the mid-teens.

Orders for LC and LCMS continue to be strong. Orders grew mid-20's globally with particularly high adoption of our two new Bio-LC products. On the LCMS front, we look forward to announcing several exciting new offerings at the upcoming ASMS conference that will expand our portfolio.

Our value proposition continues to resonate with our customers and LSAG exited the quarter with record backlog.

The **Agilent CrossLab Group** posted services revenue of $353 million. This is up 10 percent core. Growth in services was again broad-based across services contracts, preventive maintenance, compliance, education and informatic enterprise services.

The scale of our ACG business and breadth of portfolio continue to drive growth and margin expansion even in the face of inflationary pressures. Q2 marked the sixth straight quarter we've delivered growth across all markets and regions.

The **Diagnostics and Genomics Group** delivered revenue of $358 million, up 15 percent core versus 16 percent last year. Our excellent growth was led by NASD and genomics.

The NASD team delivered yet another strong quarter, generating record revenue and profitability. During the quarter, I had a chance to visit our team in Colorado and see first-hand the excellent progress that's being made meeting current customer needs and also the work underway in continuing to build for future growth with our "Train B" expansion. We remain extremely bullish about NASD's future and with Train B coming "on-line" in 2023, we're adding yet another $150 million "plus" in capacity.

Looking across the company, our One Agilent approach and focus on our customers has never been stronger. During the quarter, we were ranked number one in our industry and number two overall in customer satisfaction in "The Management 250 ranking," developed by the Drucker institute. In addition, the new Agilent Commercial organization is already resonating well and delivering successfully for our customers.

Agilent's Q2 results are yet another proof point for how we've built a resilient company that can quickly adjust to a changing environment and still post strong results. Given our results to date, along with our backlog and continued order strength, we are again raising our full year core revenue growth and EPS guidance. For the year, we are now expecting 8 to 9 percent core revenue growth and EPS of $4.86 to $4.93.

Bob will provide more detail on our Q3 outlook along with more information on what we expect for the rest of the year. After Bob's comments and before we take your questions, I will be rejoining the call for some concluding remarks.

Thank you for being on the call today and now, I will hand the call off to Bob. Bob?

<u>Bob McMahon</u>

Thanks Mike, and good afternoon, everyone. In my remarks today, I will provide some additional details on revenue and take you through the income statement and some other key financial metrics. I'll then finish up with our guidance for the third quarter and the fiscal year. Unless otherwise noted, my remarks will focus on non-GAAP results.

As Mike described, we posted solid topline results in Q2 while overcoming some difficult macro challenges in the business environment. Revenue was $1.61 billion, up a reported 5.4 percent. In the current quarter, currency was a headwind of 2.1 points while M&A added 20 basis points of growth. Core growth was up 7.3 percent, in line with expectations despite the COVID-related lockdowns in China, which primarily affected us in April.

We estimate the lockdowns deferred $50 to $55 million of revenue into future quarters, impacting growth in Q2 by roughly 350 basis points. In addition, COVID testing-related revenues were roughly a one-point headwind in the quarter.

Our largest market, <u>**pharma,**</u> grew 13 percent during the quarter, on top of 29 percent growth last year. Biopharma continued to be the main driver of results, growing 27 percent year-on-year, led by NASD. Investments in R&D programs and demand for instrumentation, consumables and critical components remains strong.

Pharma represented 37 percent of our overall revenues this quarter. To put that in perspective, in Q2 2019, effectively one year before the pandemic started, pharma represented just 30 percent of our business. This not only highlights the strength and resilience of this market, but it also demonstrates how our innovation and investments in higher growth markets continues to pay off.

<u>**Chemical and energy**</u> continued its strong trend of positive results, growing 9 percent during the quarter despite the impact of the COVID-related lockdowns in China and the conflict in Ukraine. Results were led by strong double-digit growth in advanced materials and specialty chemicals.

We expect strong demand to continue in these areas, particularly in semiconductors and battery and clean energy technologies as industry-wide capacity expands.

Diagnostics and clinical grew 5 percent on top of 13 percent growth last year as year-on-year declines in COVID-related revenues and the temporary shutdowns in China muted our results.

The **academia and government** market was a nice surprise for us, growing 5 percent in Q2 on top of 21 percent growth last year. We saw an increase in spending in this market as more university labs opened up and students returned to on-campus learning. In addition, sales activity and the funding environment continues to be healthy.

In the **food** segment, we saw growth across all regions except for China due to the shutdowns. The higher concentration of food business in China drove the food segment to decline low single digits against a very strong comparison of 22 percent growth last year.

And rounding out our end-markets, **environmental and forensics** grew 1 percent versus an 8 percent growth last year.

On a geographic basis, the Americas grew 13 percent, Europe grew 7 percent, Asia, excluding China grew 8 percent, while China declined 3 percent in the quarter as the lockdowns affected our manufacturing and logistics operations for over a month.

Regarding China, I'd like to provide some additional detail on how the quarter evolved and how we expect to see the recovery progress. First, as Mike said, demand remains strong with the order growth of about 20 percent, despite the temporary COVID lockdowns.

Second, our business in China was tracking very well with our expectations through late March when production and our main logistics hub in Shanghai were shut down and remained closed throughout April. We were able to partially reduce the impact of the lockdown by shifting production to other factories where possible and adjusting the shipping routes into and out of China.

We expect the $50 million to $55 million in revenue to be recovered throughout the rest of the calendar year, so it is deferred, not lost.

In terms of phasing, we expect to continue to ramp our operations and anticipate modest recovery of the Q2 impact in Q3. We expect the majority of the recovery to occur in fiscal Q4 with some spillover into November and December, which is our first fiscal quarter of 2023. This phasing is baked into our updated guidance.

Now turning to the P&L, the team continues to execute at a very high level. Second quarter gross margin was 55.7 percent, up 30 basis points from a year ago as pricing actions and productivity helped offset inflationary pressures tied to on-going supply chain constraints and higher logistics costs.

Operating expense leverage and strong cost management helped drive very healthy incremental improvements as we delivered an operating margin of 25.3 percent, up 140 basis points from last year.

Our tax rate for the quarter was 50 basis points better than forecast, helping us deliver earnings per share of $1.13, up 16 percent versus last year, and exceeding our expectations.

Looking at cash flow and our balance sheet, we generated operating cash flow of $283 million in the quarter while investing in $64 million in capital expenditures during Q2, with the year-on-year increase primarily related to the NASD expansion. Cash flow in the quarter was impacted by the transitory impact of COVID-related lockdowns in China as well as increased inventory to fulfill strong demand in a challenging supply chain and logistics environment, as expected. We are still on track to deliver our cash flow forecast for the year.

During the quarter, we again took advantage of market volatility to repurchase $234 million worth of shares. We also paid out $63 million in dividends, returning a combined total of $297 million to shareholders.

Our balance sheet continues to be healthy with a net leverage ratio of 0.9 times. Earlier this month, we refinanced $600 million in senior notes opportunistically, and now have no long-term debt maturing until 2025.

As we stated last quarter, our approach given current market conditions is to continue to be aggressive in deploying our capital. Given our strong balance sheet and confidence in the future, we intend to deploy another $250 million in opportunistic share repurchases in Q3 while continuing to actively look at M&A opportunities.

Now, let's move to our improved full year guidance and our outlook for the third quarter.

Given the strong business performance in the first half of the year and order backlog, we are raising our full year core revenue growth to an expected range of 8 to 9 percent, up a full point from our previous guide. This core revenue takes into account the recovery phasing in China, as well as a $35 million, or 55-basis point headwind due to the conflict in Ukraine.

While we've increased our core growth expectations, the dollar has again strengthened considerably since our last guide, resulting in estimated currency headwinds of $170 million for the year, up $60 million since our last guide. And the impact of M&A remains unchanged.

This results in maintaining our full year reported revenue guidance range of $6.67 to $6.73 billion for the full year.

We have also increased our EPS guidance for the full year to $4.86 to $4.93 per share. This is up from the previous range of $4.80 to $4.90 per share, and now represents 12 to 14 percent growth versus fiscal year 2021.

For Q3, we're expecting revenue to range from $1.625 billion to $1.650 billion. This represents core growth between 7 and 9 percent. We expect operations in China to ramp and be fully operational before the end of the quarter and continue to accelerate into Q4.

Given the strengthening of the dollar, exchange rates are expected to have a negative impact of about 4.7 points on the reported growth in the quarter.

Closing out our Q3 guidance, non-GAAP EPS is expected to be in the range of $1.20 to $1.22, up 9 to 11 percent versus the prior year. This is based on a 14 percent tax rate and 300 million diluted shares outstanding.

The Agilent team once again performed extremely well in Q2 under some very challenging circumstances. At the same time, our business remains strong, and I'm confident we will continue to deliver strong results in Q3 and through the rest of the year.

With that, Mike, I will turn it over to you for some concluding comments.

Mike McMullen – Concluding Comments

Thanks Bob.

Before we take your questions, I would like to share some thoughts with you on the current environment. As you know, we're living in very dynamic times. However, our end markets remain strong. Our build and buy growth strategy is working.

What is also very clear is the ability of the Agilent team to continue to deliver in a challenging external environment. We have built a resourceful, quick moving team and a resilient business model that has shown again-and-again, time-after-time, that we can successfully address any challenges or obstacles that come our way.

We delivered inline growth, increased margins by 140 basis points and exceeded our EPS expectations during a time of rapidly growing inflation, continued supply chain challenges and the effects of a COVID-related lockdown in a key market.

In times like this, our customers want to work with people and companies they can rely on. This works to our advantage, and I remain confident in our growth strategy continuing to deliver, and in the power of the unstoppable One Agilent team. Our growth drivers remain intact, and our business prospects remain strong now, and into the future. Thank you.

And now, back to Parmeet as we take your questions. Parmeet?