



Agilent Technologies Second Quarter Fiscal 2014 Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you and welcome everyone to Agilent's Second Quarter Conference Call for Fiscal Year 2014. With me are Bill Sullivan, Agilent's president and CEO; Ron Nersesian, president and CEO of Keysight Technologies; and Didier Hirsch, Agilent senior vice president and CFO.

Joining in the Q&A after Didier's comments will be the Presidents of our Chemical Analysis and Life Sciences and Diagnostics Groups, Mike McMullen and Fred Strohmeier. Also joining from Keysight will be Neil Dougherty, CFO, and Guy Séné, senior vice president of R&D and sales.

You can find the press release and information to supplement today's discussion on our website at www.investor.agilent.com.

While there, please click on the link for "financial results" under the "Financial Information" tab. There, you will find an investor presentation along with revenue break outs, business segment results and historical financials for Agilent's operations. We will also post a copy of the prepared remarks following this call.

Today's comments by Bill, Ron and Didier will refer to non-GAAP financial measures. You will find the most directly comparable GAAP financial metrics and reconciliations on our website.

We will make forward-looking statements about the financial performance of the company and the separation of the electronic measurement business. 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.

Lastly, we expect the third quarter to be the final quarter before Agilent's Electronic Measurement Group begins operating as Keysight Technologies. Today's comments will also refer to the Electronic Measurement Group as Keysight.

And now, I'd like to turn the call over to Bill.

BILL SULLIVAN

Thanks Alicia, and hello everyone.

Today Agilent reported second-quarter revenues and EPS in line with commitments, with solid growth in orders. Revenues of \$1.73 billion were unchanged from a year ago. Q2 orders of \$1.81 billion were up 7 percent over last year.

Adjusted earnings of 72 cents per share were at the mid-point of our guidance. Operating margin was 18.2 percent.

Keysight revenues came in at the high end of expectations. LDA revenues were slightly below the low end of our guidance. Both businesses built backlog as orders accelerated late in the quarter. Book-to-bill for Agilent was 1.05, positioning us well as we move into Q3.

Our work to split the company continues to proceed smoothly. By the beginning of August, we expect Keysight to operate independently as a wholly owned subsidiary of Agilent. We continue to expect the separation to be completed by early November.

Today, I will share performance highlights for the life sciences, diagnostics and applied markets that will become the new Agilent.

Following my remarks, Ron will discuss the electronic measurement markets that will become Keysight. Finally, Didier will provide a more detailed discussion of Agilent's overall financial results, as well as our guidance for the fiscal third quarter and fiscal year.

Turning to LDA, second-quarter revenues of \$988 million grew 2 percent year over year on both a reported and a core basis. We saw good growth across our Pharma, Clinical and Diagnostics, Energy and Food businesses; tempered by results in the Academic & Government and Environmental markets.

Orders accelerated at the end of the quarter, as we built backlog. Book to bill for LDA was 1.04, with orders of \$1.03 billion up 4 percent, or 5 percent on a core basis, over last year.

Operating margins, adjusted to volume, were in line with guidance.

Turning now to performance by end-market...

In Life Sciences, we saw strength in Pharma/Biotech, up 4 percent, led by demand from mid-sized and specialized Pharma customers. Diagnostics and clinical revenues were up 7 percent, driven by record companion diagnostics growth and strong demand for CGH arrays and target enrichment solutions.

Academic & Government remained soft, down 6 percent year over year, as government spending delays in the U.S. and China pressured results.

In Applied Markets, Food Testing was up 10 percent, with globalization of the food supply and brand protection continuing to drive strong demand. Energy grew 2 percent, led by the U.S. and refinery projects in the Middle East. Conversely, Environmental and Forensics were down 5 percent, impacted by government funding.

On a regional basis, LDA performance was mixed. Double-digit growth in Europe was broad-based across markets. In the Americas, revenues were down 2 percent, on delays in U.S. government spending and softness in Latin America.

Asia Pacific was down 3 percent, affected by slower government funding and lengthened approval cycles in China. We saw improvement in China towards the end of the quarter.

Within LDA, our Life Sciences and Diagnostics Group had Q2 revenues of \$577 million, up 1 percent from a year ago, as recurring revenues offset softness in instrumentation. Orders of \$598 million were up 3 percent year-over-year. Operating margin was 13 percent for the quarter.

In early May, LDG recently introduced the latest version of Chromatography Data System (CDS) software, called OpenLAB CDS. New features include flexible data capture, improved automation and faster data analysis.

We also introduced a range of new LC products during this week's HPLC 2014 in New Orleans. Announcements include a new, next-generation UHP-LC multi-sampler, which sets new benchmarks in throughput, speed and carryover. We also introduced an updated two-dimensional LC-system for higher-resolution applications.

And we are launching a series of new LC/MS and GC/MS products at ASMS next month. These solutions are differentiated by higher performance and lower cost of ownership, making them ideally suited for the applications in our core markets.

The Chemical Analysis Group had Q2 revenues of \$411 million, up 3 percent and led by strong demand for GCMS, ICPMS and Services. Orders of \$432 million grew 6 percent year-over-year. Operating margin was 22 percent for the quarter.

The ultra-high performance 7200 GC/Q-TOF continues to exceed expectations, with Europe leading all regions for the adoption of high-resolution, accurate GC/MS.

CAG recently signed a major contract with a leading environmental company in Beijing. Agilent will supply GC/MS instruments for on-line air monitoring systems, related to ozone and other airborne pollutants.

Looking forward, LDA's outlook remains positive, supported by our backlog build, a robust pipeline of new product releases, and expectations for increased flows in government spending.

We remain committed to creating shareholder value by increasing our organic growth rate, delivering complete workflow solutions for our customers, and growing earnings faster than revenues.

Moving forward, our priorities are to continue our late-Q2 order momentum into Q3, launch a series of new product families, and continue to drive our manufacturing cost reduction.

LDA revenues for the fiscal third quarter of FY14 are expected to be between \$1.0 billion to \$1.02 billion, or nearly 5 percent core growth at the midpoint. We expect operating margins at the midpoint of 18.5 percent.

For the full year, we now expect LDA revenues to range from \$4.02 to \$4.12 billion with operating margins at the midpoint of 19.3 percent.

Didier will provide additional details in his commentary.

Thank you for being on the call. Now I'll turn it over to Ron to talk about Keysight and the Electronic Measurement business.

RON NERSESIAN

Thank you, Bill, and hello everyone.

I have three key headlines for you regarding Keysight's performance in Q2.

- First, Keysight came in at the top end of its revenue and operating profit margin guidance.
- Second, Keysight orders returned to growth in Q2.
- And third, Keysight is on track with its plans to separate from Agilent.

Now, moving to the specifics, revenues of \$743 million declined 2 percent, or 1 percent on a core basis, while orders of \$782 million were up 11 percent year-over-year, which resulted in a book-to-bill ratio of 1.05. Keysight continued not only to effectively manage gross margins and spending, but also had a favorable mix profile this quarter. Keysight generated operating profit of \$148 million and an operating margin of 20 percent for the quarter.

Looking to our end market performance, Aerospace and Defense revenues declined 6 percent year-over-year. With U.S. budget approvals in place, direct government demand has improved, while prime contractor business in the U.S. remains soft. International Aerospace and Defense demand was mixed, but steady.

Industrial / Computers / Semiconductor revenues increased 3 percent year-over-year. Investments in next-generation semiconductor process technologies continued in the second quarter, while Computer markets remained soft.

Communications revenues declined 6 percent year-over-year. We continue to see strength in 4G base station infrastructure demand, while handset/device manufacturing remains moderate.

On a regional basis, we saw very good growth in Asia excluding Japan, which grew over 20 percent with strength across most market segments. The Americas region was down double-digits year-over-year versus a strong compare. Japan declined 12 percent, or down 4 percent on a core basis which excludes the impact of currency. Europe was essentially flat year-over-year.

As I discussed during our Analyst Day in March, Keysight is transforming its portfolio with the goal of returning to market growth rates.

This quarter we began shipping both the UXM wireless test set for R&D and the EXM wireless test set for manufacturing. The EXM wireless test set won “2013 Product of the Year” award by editors of Electronic Products China.

In April Keysight expanded its performance network analyzer series with a lower priced model targeted at low-cost RF components used in handsets and consumer products. Keysight also introduced two high-performance portable oscilloscopes deploying next-generation technology — one set a new standard for signal integrity and the other set a new standard for price and performance.

We expect Keysight to begin operating as a subsidiary of Agilent on August 1, and to complete the spin-off in early November. As part of our journey, we are announcing today that we expect Keysight common stock to trade on the New York Stock Exchange under the ticker symbol KEYS.

In addition, at the end of this quarter we will implement an operational cut-over of our IT systems. This transition requires tight coordination of our shipment and delivery plans. We are working with customers on the cut-over which could cause some revenue to shift between the quarters.

As Bill has said, it takes a lot of work to create two great companies from one. Along with all of the excellent internal work, we continue to focus on our customers and their testing solution needs.

Turning to the outlook in Q3, we expect Keysight to return to revenue growth with revenues in the range of \$720 to \$760 million. We project core growth at the midpoint to be 5 percent and operating margins at the midpoint to be 18.4 percent.

For the full year, we expect revenues in the range of \$2.86 to \$3 billion, which represents 2 percent core growth at the midpoint. Operating margins for the full year are expected to be 18.9 percent at the midpoint.

I will now turn it over to Didier to provide the details of Agilent's overall financial results.

DIDIER HIRSCH

Thank you, Ron, and hello, everyone.

To recap the quarter, our revenue of \$1,731M, operating margin of 18.2% and EPS of 72 cents were all at the midpoint of our guidance. Orders exceeded our expectations, but the quarter-end order skew was also higher than usual.

By business, most of the operating profit variance versus the midpoint of our guidance was due to volume and mix. Please note that Q2 core revenue growth by segment and by geography is reported on the slide deck posted on our website. This quarter, currency subtracted about 0.9 percentage points from our year-over-year revenue growth, and acquisitions had no material impact.

Finally, we bought back \$50M of stock in Q2 and generated \$272M in free cash flow, slightly higher than last year.

I will now turn to the guidance for our third quarter. We expect Q3 revenues of \$1.74B to \$1.76B and EPS of 72 to 74 cents. At midpoint, revenue will grow 5% on a core basis. Our 18.5% projected operating margin at midpoint will be 30 bps higher than Q2 FY14 and 20 bps higher than Q3 of last year.

Remember that we initiated a drastic cut in discretionary expenses early February of last year that resulted in significant expense reductions in the ensuing months, so we face a tough compare. While we are maintaining our spending discipline, we are also investing in key growth initiatives.

Now to the guidance for Fiscal Year 2014. We are confirming the guidance we provided last quarter, for both revenue and EPS. As a reminder, we expect FY14

revenues to range from \$6.9B to \$7.1B and FY14 EPS to range from \$2.96 to \$3.16.

With that, I will turn it over to Alicia for the Q&A