



Agilent Technologies Fourth Quarter Fiscal 2016 Conference Call Prepared Remarks

ALICIA RODRIGUEZ

Thank you, and welcome everyone to Agilent's Fourth Quarter Conference Call for Fiscal Year 2016. With me are Mike McMullen, Agilent's president and CEO, and Didier Hirsch, Agilent's senior vice president and CFO.

Joining in the Q&A after Didier's comments will be Patrick Kaltenbach, president of Agilent's Life Sciences and Applied Markets Group; Jacob Thaysen, president of Agilent's Diagnostics and Genomics Group; and Mark Doak, president of the Agilent CrossLab Group.

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. You will find an investor presentation along with revenue breakouts and currency impacts, 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 Mike 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 refer to "core" revenue growth, which excludes the impact of currency, the NMR business, and acquisitions and divestitures within the past 12 months.

Unless otherwise noted, all references to increases or decreases in financial metrics are year over year. Guidance is based on exchange rates as of the last day of the reported quarter.

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, let me turn the call over to Mike.

MIKE MCMULLEN

Thanks, Alicia, and hello everyone.

I'm very pleased to announce that our Agilent team ended 2016 with another strong quarter of excellent results.

I will start by looking at our key numbers from the quarter. First, we continued to deliver above-market growth. Revenues of \$1.1 billion exceeded the high end of the guidance by a sizeable \$41 million, and were up 6.3 percent on a core basis. We were the first surprised by the strength of our instrument business in Pharma, China and Europe; which far exceeded our expectations.

Second, our adjusted EPS of 59 cents was 7 cents above the high end of our guidance. Finally, we continued our track record of improving profitability, as we delivered another quarter of operating margin expansion. Adjusted operating margin of 22.5 percent was up 60 basis points from Q4 of fiscal 2015.

Turning to our full-year results, core revenue continued to outperform the market, growing 5.9 percent. We increased operating margins 110 basis points to 20.7 percent from 2015. These results drove a 14 percent increase in adjusted EPS for the full-year.

We are capping off the second year of our company transformation with stellar performance by the Agilent team. Our fourth-quarter and full-year results demonstrate our continued ability to win in the market. We are outgrowing the market, while expanding operating margins and fully leveraging our strong balance sheet.

In the past year, we distributed \$150 million in cash dividends; repurchased \$434 million of our shares; and invested \$480 million directly into the business through M&A, strategic transactions and capital expenditures.

Let me now address what is happening in our end-markets and business groups. I'll start with the end markets.

Our Q4 trends were similar to what we experienced last quarter, with Pharma and Academia & Government being the exceptions.

We had expected continued strength in Pharma, but our 16 percent growth on a difficult compare exceeded our expectations. Growth is being driven by strong customer acceptance of our new products and enterprise service offerings.

Academia & Government's decline of 2 percent was less than expected. European spending is holding up better than projected, while U.S. government investments continue to lag 2015 spending levels.

Clinical and Diagnostics grew 8 percent over last year, led by continued growth in reagents.

Within our applied end-markets, Food is up 10 percent, with strong demand in China and the Americas. China also drove growth in the Environmental market, up 3 percent.

Chemical & Energy declined 3 percent in line with expectations, due to the continued effect of crude oil prices and macro-economic uncertainties. We expect this market to remain challenging

for the rest of calendar year 2016 and into 2017, with no significant downward or upward movements.

Geographically, Asia – led by China – and Europe were stronger than forecast. Our Asia business – excluding Japan – grew double digits, driven by greater than 25 percent growth in China. While the overall European market remains challenged, we delivered solid mid-single-digit growth. European Pharma and Food markets were strong, and Academia and Government funding was stable with Q3.

Japan and the Americas were flat, with growth constrained by continued Chemical and Energy market weakness – and specific to the U.S., slow U.S. government funding.

Moving on to the business groups...

Life Sciences and Applied Markets Group delivered core revenue growth of 5 percent. Better-than-expected revenues from our analytical lab instruments business were driven by an attractive combination of introducing new products into growing markets.

This applied in particular to our new line-up of Chromatography and Mass Spectrometry products targeted at the Pharma and Applied Food, Environmental and Forensics markets. LSAG's operating margin for the quarter was 22.8 percent, up 280 basis points from a year ago.

We are building for the future. In August, we introduced the transformational Intuvo 9000 GC system. Building on our recognized GC leadership, the Intuvo system revolutionizes the way users perform gas chromatography. Industry experts recognize the unique innovation being delivered by Agilent, with press coverage at 100-percent positive. Intuvo is featured this month on the cover of LC/GC magazine, a major trade publication.

Customer response is also very positive to this introduction, confirming our undisputed market leadership in gas chromatography. We anticipate a measured up take in revenue. Limited initial

shipments are expected in Q1 of fiscal 2017, with volumes expected to increase over subsequent quarters.

Another industry-unique product, the Agilent 8900 triple quad ICP-MS system, which we just introduced in Q3 is also being well received in the market. This instrument is rapidly becoming the solution of choice in labs that demand the highest standards of performance.

Next, the Agilent CrossLab Group continues to deliver strong, sustained growth, with core revenue up 8 percent. Growth is healthy in both services and consumables. ACG's operating margin for the quarter was 22.7 percent, down 240 basis points from a year ago and in line with expectations.

ACG's results were driven by strong Pharma, Food, Clinical and Diagnostics markets, where our CrossLab customer value proposition is being well received. Unlike our instrument business, ACG also grew in the Chemical and Energy markets. Laboratories supporting strong production levels drove demand for consumables. There is also continued demand for services, as customers focus on keeping their older instruments operational.

We are investing for the future in ACG. We just introduced a new range of innovative and differentiated supplies. These new offerings enable the Agilent Intuvo 9000 GC to be the most efficient and cost-effective premium GC to own and operate.

We continue to successfully integrate the recently acquired iLab business, which brings differentiated capabilities to core lab managers.

Last – but certainly not least in terms of impact – the momentum in the Diagnostics and Genomics Group continued, with delivery of 8 percent core growth. Our laser focus on improving the previously acquired Dako business is paying off. The Pathology business continues its steady climb back to market growth rates, with strength in reagents and companion diagnostics.

Our Nucleic Acids Solutions business, for which we recently announced a significant production capacity investment, grew by double digits. This growth reflects the increasing demand for oligonucleotides for RNA-based drugs.

DGG's operating margin for the quarter was 19.6 percent, up 40 basis points from a year ago.

In October, there was some exciting news from Merck for lung cancer patients and for Agilent. Merck's KEYTRUDA is now approved by the FDA for first-line treatment for metastatic non-small-cell lung cancer for patients with high rates of PD-L1 expression. In conjunction, Agilent's pharmDx companion diagnostics PD-L1 test is now approved for expanded use. This is the first time an Agilent's PD-L1 companion diagnostic is approved for first-line testing.

The theme of investing for our future is also evident in DGG. We launched a comprehensive offering of pooled CRISPR libraries for functional genomics. This will help accelerate research into complex diseases and drug discovery.

We signed an agreement with Burning Rock Biotech to develop cancer diagnostics in China based on Agilent SureSelect solutions. And we broke ground and initiated construction on the previously announced \$120 million investment in a new factory in Colorado, to expand nucleic acid production capacity.

Turning now to operating margin...

We remain focused on operating margin improvement. Since the new Agilent leadership team was appointed, we have delivered seven consecutive quarters of improved operating margins and strong growth.

Despite continued challenges in the Chemical and Energy business, we have improved adjusted operating margin by 280 basis points in the first two years of the company's transformation. We have completely absorbed and offset the \$40 million of dis-synergy costs due to the spin-off of Keysight.

On the operations front, our “Agile Agilent” program continues to simplify the company and lower operating costs. This program is designed to keep us nimble, improve our interaction with customers, and lower our costs. It is having an impact, and will continue to deliver savings in 2017 and beyond.

In the coming year, we will realize cost savings from the completion of the integration of Dako in early 2017, a simplified enterprise IT systems environment, and other cost savings initiatives.

Turning to our FY17 market and company outlook...

As a reminder, our shareholder value creation model for superior earnings growth is to outgrow the market, and expand operating margins with a balanced deployment of our capital.

Didier will go through the specifics of our Q1'17 and full-year guidance. I want to share our thinking about end-markets and our initial guidance philosophy, given an environment of increased uncertainty. This is a change since our last call and the May 2016 Analyst and Investor day.

In our end-markets, we expect continued strength in Pharma, accompanied by continued solid growth in the Food, Environmental, and Clinical Research and Diagnostics markets.

Geographically, China and India are expected to grow at significantly higher rates than other countries. There remains considerable uncertainty around European markets. We are forecasting moderate growth in the U.S., with U.S. government policies and spending, and Chemical and Energy markets being the “wild cards.”

Chemical and Energy, while entering a period of easier compares and improved oil prices, has not yet returned to growth. We expect a continued subdued Academic and Government research market in the coming year, until uncertainties resulting from Brexit and the U.S. elections play

out. We are also keeping a watchful eye on how potential new U.S. government driven trade and currency valuation discussions could impact our business.

We finished fiscal 2016 very strongly, and we are well-positioned for future growth with a rich pipeline of new offerings.

In our initial revenue guidance for 2017, however, we want to be on the cautious side. We want to see more clarity on U.S. and European government actions, and have better indicators of when we will return to growth in our industrial end-markets.

Predicting end-market growth in today's uncertain political and economic environment is challenging. However, I can predict quite confidently that we will continue our track record of outgrowing the market, whatever market environment we encounter. We continue to expand our customer channel reach and fortify our portfolio, which strengthens us well for the coming year and beyond.

The transformation of Agilent we discussed at the May Analyst and Investor day is in full force. The new leadership team – put in place in early 2015 – continues to deliver strong operating results each and every quarter. We are building momentum for future growth.

We have improved our adjusting operating margins by 280 basis points over the past two years – and our march to improved operating margins will continue in 2017.

However, in our initial operating margin and earnings per share guidance for fiscal 2017, we want to be on the cautious side.

Since our May Analyst and Investor day meeting, changes in exchange rates, pension expenses and the recent iLab acquisition are having a short-term dilutive impact on our operating margins of 0.5 percent. The Agilent team, however, is laser-focused on improving another 130 basis points of operating margin. We have internal action plans aligned with achieving a 22-percent operating margin goal in fiscal 2017, excluding M&A impact.

This is the primary goal for our executive team's compensation. We continue to hold ourselves to a higher level of performance expectations than reflected in our initial full-year earnings guidance.

As you assess our future possibilities, I will leave you with a few thoughts. We are expanding our product portfolio and extending into adjacent markets. We are improving the customer experience by streamlining processes and modernizing systems – making the company more efficient and customer friendly.

Our Agile program has and will continue to deliver incremental improvements in operating margins.

The One Agilent team continues to work well together and is determined to win in the market. We believe we are well positioned to sustain our strong operational performance and achieve our long-term goals. The entire Agilent team is energized and committed to deliver future growth.

Thank you for being on the call today. I will now turn it over to Didier, who will provide additional insights on our financial results and our initial guidance for our fiscal Q1 and full year 2017.

Didier?

DIDIER HIRSCH

Thank you, Mike, and hello, everyone.

As Mike stated, we are very pleased with our Q4 and full-year performance, both well over the high-end of our guidance.

We delivered above-market core revenue growth of 6.3% and 5.9% respectively, and our OM, adjusted for income from Keysight, was up 60 bps and 110 bps respectively. Our full year EPS, at \$1.98, is 14% higher than the previous year. Please note that we have reduced our pro forma tax rate by 1 percentage point, which had a 2 cents impact on our EPS.

Our operating cash flow for the full year, at \$793M, reflects our strong overall performance. Turning to capital returns, for the year, we returned \$584M to shareholders in the form of dividends and buybacks, or 89% of our free cash flow.

I will now turn to the guidance for Fiscal Year 2017

As Mike stated, our initial guidance, like last year, assumes what we believe to be appropriate caution. Our FY17 revenue guidance of \$4.35B to \$4.37B corresponds to a core revenue growth of 4.0 % to 4.5%. It is based on October 31st exchange rates and currency has a 0.6% negative impact on revenues. We project FY17 adjusted OM of 21.0% to 21.5% and FY17 EPS of \$2.10 to \$2.16, growing 8% at midpoint.

As you update your models for FY17, please consider the following 10 points:

1. Annual salary increases will be effective December 1, 2016.
2. Stock-based compensation will be about \$59M. As we front-load the recognition of stock-based compensation, the Q1 expense will be about \$23M.
3. The reduction in bond yields is negatively impacting our annual pension expenses by about \$12M
4. Depreciation is projected to be \$104M for the fiscal year.
5. The non-GAAP effective tax rate is projected to remain at 19%.
6. We plan to return approximately \$600M in capital to shareholders, including \$170M in dividends and \$430M in buybacks, subject to customary conditions.
7. We plan to borrow \$250M in the second half to fund a portion of our capital returns.
8. Net interest expense is forecasted at \$71M, and other income at \$11M.

9. For purpose of our EPS guidance, we have assumed a diluted share count of 324M, 5M less than the average diluted share count in FY16.
10. We expect operating cash flow of \$825M and capital expenditures of \$200M, about \$60M over FY16, mostly due to the investment in a second nucleic acid facility.

Finally, moving to the guidance for our first quarter

First, please note that Lunar New Year falls in Q1 this year, versus Q2 last year, meaning about \$15M of revenues shifting from Q1 to Q2. We expect Q1 revenues of \$1.04B to \$1.06B and EPS of 48 to 50 cents. At midpoint, revenue will grow 2.2% YOY on a core basis, and EPS will grow 7%. As customary, Q1 EPS is negatively impacted by the December salary increase, front-loading of stock-based compensation, and the increase in payroll taxes due to the disbursement of the variable and incentive pay of the previous year.

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