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JNPR - Q1 2012 Juniper Networks Earnings Conference Call

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## PRESENTATION

### Operator

Greetings, and welcome to the Juniper Networks first quarter 2012 earnings results conference call. At this time all participants are in a listen only mode. A brief question and answer session will follow the formal presentation.

(Operator Instructions)

As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Kathleen Nemeth, Vice President Investor Relations for Juniper Networks. Thank you, Ms. Nemeth, you may begin.

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**Kathleen Nemeth** - *Juniper Networks, Inc. - VP - IR*

Thank you, Operator. Good afternoon and thank you everyone for joining us.

Here on the call today are Kevin Johnson, Chief Executive Officer; Robyn Denholm, Chief Financial Officer; and Stefan Dyckerhoff, Executive Vice President Platform Systems. Before Kevin gets started, I would like to highlight changes to our financial reporting which were reflected in today's earnings press release.

As we have discussed previously, Juniper is aligning our business segment reporting to the Company's organizational structure and focus on its platform and software strategy. We believe this change will provide investors with increased financial reporting transparency and will enable better insight into the market and performance trends driving the Company's business. Juniper's two reportable segments are now the Platform Systems



Division, which will often be referred to as PSD; and Software Solutions Division, or SSD. Our press release provides a description of each segment, including the products within each segment. There is a table included in Appendix 2 which identifies the specific products by segment within routing, switching, and security.

The PSD segment aligns primarily with the Infrastructure segment under the historical reporting approach and consists of routing, switching, and security products and services. Note that security products such as the Branch SRX, Branch Firewall, and J-Series product families, which are now in PSD, were historically reported as part of our SLT segment. The SSD segment aligns primarily with the SLT segment under the historical reporting approach, and consists of security and routing products and services. Note that routing products such as routing services software, which are now in SSD, were historically reported as part of our Infrastructure segment. Detailed information, including 2011 and 2010 announced as they would have been reported under the new approach, is included in the appendix of today's press release and are provided in Excel tables on the Investor Relations page of our website. These include quarterly segment revenues with product detail, segment contribution margins, and corporate unallocated expenses.

Please remember when listening to today's call that statements concerning Juniper's business outlook, economic and market outlook, future financial operating results, and overall future prospects are forward-looking statements that involve a number of risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors including economic conditions, generally or within the networking industry, changes in overall technology spending, the network capacity requirements of service providers, the timing of orders and shipments, manufacturing and supply chain constraints, variation in the mix of products sold, customer perception and acceptance of our products, litigation, and other factors listed in our most recent 10-K filed with the SEC. All statements made during this call are made only as of today. Juniper undertakes no obligation to update the information in this conference call in the event facts or circumstances change after the date of this call.

In discussing the financial results, Robyn will first present results on a GAAP basis, and for purposes of today's discussion, will also review non-GAAP results. For important commentary on why the management team considers non-GAAP information a useful view of the Company's financial results, please consult our 8-K filed with the SEC today. For the detailed reconciliation between GAAP and non-GAAP results, please see today's press release. In general non-GAAP results exclude certain non-recurring charges, amortization of purchased intangibles, and other acquisition charges and expenses related to stock-based compensation.

On today's call Robyn will also be providing forward-looking guidance. As a reminder, guidance is provided on a non-GAAP basis, other than that with respect to revenue and share count. All guidance is forward-looking and actual results may vary for the reasons I noted earlier. GAAP guidance measures are not available on a forward-looking basis due to the high variability and low visibility with respect to certain charges, which are excluded from the non-GAAP guidance estimates. Please note that today's call is scheduled to last for one hour and please limit your questions to one per firm.

With that I'll turn the call over to Kevin.

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**Kevin Johnson** - Juniper Networks, Inc. - CEO

Thanks, Kathleen and welcome everyone.

Juniper executed well in the first quarter, delivering results that were better in a forecast in a market environment, that as expected, continued to be dynamic by geography. I'll provide some detail on how we see business unfolding here in the first half of the year, including the solid traction we're seeing with our new products. I've also asked Stefan Dyckerhoff, who heads our Platform Systems Division, to provide some further depth on the progress we are making on our innovation agenda. After Stefan's comments, Robyn will provide the financial review.

First quarter results reflect demand from our large service provider customers, and some declines in enterprise routing. Geographically, we saw continued headwinds in EMEA as expected, but we saw good wins in activity across all of our theatres. We're also seeing new products contribute to results, including a solid first full quarter of revenue from our recently introduced T4000 core router. Our switching performance remains solid in light of the market environment, and we're gaining traction with our QFabric offerings. In Security, SRX posted good results in the first quarter.



Customers have responded very positively to the recent update of the user interface of security configuration and device management software. We are continuing to manage prudently and carefully in this environment.

Service providers continue to be thoughtful with their spending. Our largest customers have a clear focus on maximizing efficiency as measured by capital spend to revenue. The focus on efficiency is supporting important architectural transitions, such as the convergence of the wire line and wireless Edge, which is a great opportunity for MX Series of Edge routers. In fact, our recent MX capacity upgrades, coupled with the T4000 core routers' powerful throughput, enables Juniper to leverage our install base on both the Core and the Edge. These differentiated products are helping customers reduce their cost per bit of traffic while driving operating efficiencies across their business.

Service providers' drive for capital spending efficiency aligns with the strategic priorities that drive our innovation agenda. We are innovating in areas that are highly relevant to our customers, both in mobility and in the cloud. We're delivering differentiated solutions that change the economics and experience of networking for our customers. We are taking an architectural approach with solutions that enable our customers to address some of the most critical challenges they face. And it's important to keep in mind that architectural changes take time and close customer collaboration. We feel good about how our customers, both existing Juniper customers and new customers, are responding to our approach and our solutions.

The T4000 generated good revenue in the first quarter. We recorded our first PTX revenues and are pleased with the orders we are receiving. We continue to win new customers with QFabric and we are enabling numerous production deployments. Within Security we continue to strengthen our portfolio with new features and improved usability. As we move forward, we will continue to focus on execution. Our new products are a result of good execution in R&D and we continue to expand our go-to-market capabilities. Our innovation agenda is on track. We are confident in the value of the solutions we are delivering, and the customer traction and feedback we are seeing supports that confidence.

We believe in the long term fundamentals driving the new network. Our strategy for long term value creation is clear and it consists of five key elements. One, we are a pure play in high performance networking, with an addressable market opportunity for Juniper that is large and growing. Two, we are an innovation-driven company which means we will continue to invest in R&D that delivers customer value. Three, we are leveraging our R&D investment across both the service provider and enterprise customer base. Four, we are diversifying that customer base by broadening our service provider business and by expanding breadth and depth in both service provider and enterprise. And five, we are complimenting our system strategy with the software business centered on the one Junos platform.

Our long-term view is positive. Certainly the near-term environment requires continued caution, and we are addressing that with a focus on execution and adherence to our operating principles. The trends of mobile internet and cloud have created the potential for transformational opportunity for Juniper. With great innovation and great execution, we believe we are positioned very well to capitalize on the opportunity in front of us.

With that, I'll hand it off to Stefan.

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**Stefan Dyckerhoff** - Juniper Networks, Inc. - EVP Platform Systems

Thanks, Kevin. It is a pleasure to join the earnings call this quarter.

In February, while attending Mobile World Congress, Bob Muglia and I had the opportunity to present our strategy innovation agenda focused on systems and software. As we articulated, Juniper strategy for the new network enables customers to improve economics and experiences of networking. We are doing this by offering a common network platform with powerful and programmable systems, on top of which Juniper and our ecosystem partners can build software-driven solutions.

We have aligned our organizational structure to our new network strategy, with the formation of the Platform Systems Division and the Software Solutions Division, which reflect how we manage our business. We have introduced the new network platform architectures which allow us to view our product, solutions, and value propositions through the customer lens, segmented by network domain. We are an innovation-driven company which partners closely with our customers to solve their hardest networking problems.



A critical component of our strategy is our commitment to leveraging our R&D investment in order to develop solutions that span both service for the customers and our growing enterprise customer base. The new products we have brought to market in the last year, from QFabric to T4000 to PTX to MX upgrades and ACX, were all designed and built to deliver differentiated value for both segments. We now have the strongest and most robust portfolio in the history of the Company. The architectural approach we are taking with our innovation agenda requires patience and close work with our customers. We are in the midst of that, and we feel good about the progress we are making on our new products. I'll walk through this in more detail, starting with the Core.

Several customers have embraced our vision of the convert super core, and we are seeing robust early demand for both of our new products, the T4000 and the PTX. We saw good initial revenue performance for T4000 in the first quarter, with recent buyers of a product including Australia-based Telstra and UK-based Virgin Media. We have strong customer engagement for the PTX across all geographies, including orders from customers such as the London Internet Exchange. We have been pleased with the customer reaction to the product. We also had important product news on the Edge in early 2012.

In addition to the switch fabric upgrades we started shipping in Q4 2011, which allow our customers to double the performance of their MX install base, we also saw great traction for our 100-gig interfaces on MX, which started shipping in the first quarter. With the PTX T1600 and T4000 also delivering 100-gig interfaces, we have a compelling 100-gig story from convert super core to Edge. The MX product line has been the most successful product in the history of Juniper, and combined with the ACX product line for access and navigation, which we will ship later this year, we see continued growth opportunities across wireless and wire line applications.

Now let's turn to the campus and data center and talk about switching and fabric. Our EX series of products was our entry into the switching market. These products continue to be a key lever in our drive into the enterprise across campus and data center applications. The next step in our data center innovation agenda has been to simplify the next generation data center networks to one layer, driving capital efficiencies and significant operational benefits for the virtual data center and emerging clouds.

We believe our QFabrics have the industry standard for performance and simplicity, and we are satisfied with the customer response to this technology since we introduced it last year. We now have over 150 customers for the QFX product line, and are seeing them embrace the solution in a variety of different configurations ranging from top of rack installations to full fabric deployment. We are pleased to have the first full fabric deployments running in live production. Those deployments include Qihoo 360 in China and Australia-based Orica.

In Q1, we also have a QFabric win in Europe at Jan Yperman hospital in Belgium. Customer feedback overall is good, and we are encouraged with the pipeline we are building. Overall, in switching and fabric, we are pleased with the progress. We are seeing success in data center and campus, and our architectural innovation is gaining customer traction.

One of the main drivers behind the early success we are seeing has been very good execution in R&D. Our approach has always been about silicon, systems, and software; and you're seeing all three coming together in our new products. Our trio chip set is powering the MX and T4000, while our express chip set, optimized for high capacity transport, is the reason the PTX maintains four times the density of any competing product. We have also done a tremendous amount of work in our Junos R&D program, delivering capabilities which are key to the customer experience with our products. We are delivering a single network operating system to more easily integrate into customer work flow and provide an open programmable platform for rapid service innovation.

I'll conclude my comments by highlighting a few key takeaways. From silicon to systems to software, we're executing on our innovation agenda. Customer feedback around our solution has been very positive. All of our new products are in active customer engagements across all geographies, resulting in design wins, trials, and live deployments. The innovations we are bringing to market are architecture-driven. They are designed in collaboration with our customers, and in response to their needs; and, as with any new architecture, implementation is a multi-stage process. Again, we are pleased with the progress we are seeing and how we are delivering against our innovation agenda.

I will now turn the call over to Robyn.



**Robyn Denholm** - Juniper Networks, Inc. - EVP and CFO

Thank you, Stefan, and good afternoon, everyone.

Juniper's results in the March quarter reflect our focus on disciplined operational excellence, with revenue and earnings exceeding our guided ranges. We are pleased with the early customer demand for our new products, reflected in orders for PTX, T4000, and QFabric. While we are still in the early phases of these new product cycles, customer feedback on our disruptive innovations is highly encouraging.

We saw a sequential increase in service provider revenue driven primarily by large US customers. As anticipated, the orders we received in the third quarter 2011 contributed to this quarter's strength in service provider revenue. This was offset by an expected decline in enterprise as a result of typical seasonality and our strong fourth quarter performance in federal routing. While we believe the long term demand fundamentals are intact, many customers continue to exercise care in the investment prioritization and project deployment. We are focused on executing our strategy while prudently managing the near term.

Looking at our demand metrics for the quarter, book-to-bill was slightly below 1. Product deferred revenue was roughly flat sequentially. Total revenue was \$1.032 billion, a decline of 8% sequentially and 6% year-over-year. Verizon continues to be a strategic customer, accounting for approximately 15% of total revenue this quarter. This was driven by demand for our routers, switches, security solutions, and services across Verizon's wired and wireless networks.

For the first quarter, GAAP diluted earnings per share were \$0.03. GAAP diluted earnings include a \$0.03 impact for charges associated with the write down of an equity investment, restructuring, and other items. Non-GAAP diluted earnings per share were \$0.16, down \$0.12 sequentially and down \$0.16 from a year ago. The decline from the first quarter of 2011 was primarily due to lower revenue and gross margins. Now let me provide some color on revenue by region, business segment, and market.

In the first quarter, the Americas were approximately 51% of total revenue, EMEA 30%, and APAC 19%. Americas revenue was up 2% sequentially and declined 9% year-over-year. The sequential growth was primarily due to the largest US service providers, while the year-over-year decline was mainly due to regional and content service providers. EMEA revenue was down 23% sequentially and up 2% year-over-year. The sequential decline was primarily attributable to comparisons against a record Q4 and a decline in service provider revenue in Southern and parts of Central Europe.

APAC revenue declined 3% sequentially and 12% year-over-year. While Japan showed sequential growth due to better performance in service provider, it was down compared to a strong quarter last year as we completed a large service provider deployment. We did see a slowdown in revenue across the rest of the region. Now let me review our revenue by segment.

Platform Systems Division revenue was \$824 million, down 8% both sequentially and year-over-year. PSD router product revenue was \$458 million, down 4% sequentially and 21% year-over-year. The sequential decline was due to a decrease in spending in enterprise. The year-over-year decline was due to lower spending by international, US regional, and content service providers. Total router revenue, including both PSD and SSD, was \$479 million. Total switching product revenue was \$124 million, down 21% sequentially from a record level in the fourth quarter. On a year-over-year basis, switching was up strongly at 23%, driven by EX45 and EX2200, as well as an increase in shipments of our QFabric solution.

Software Solutions Division revenue in the first quarter was \$208 million, down 9% sequentially and up 3% year-over-year. High-end SRX product revenue for the quarter remained strong. We saw increases sequentially and year-over-year, driven by service provider demand. We expect high-end SRX revenue to continue to fluctuate with the timing of customer deployment. Enterprise security was down sequentially and year-over-year as we work to improve the feature offerings of our enterprise security customers.

Looking more closely at the markets we address, service provider revenue was \$685 million, up 1% sequentially due to strength in routing and security. Revenue was down 8% on a year-over-year basis due to reduced demand in routing. Enterprise revenue was \$347 million, down 22% sequentially and 3% year-over-year. The sequential decline was due to lower routing business coming off a strong Q4 in federal, and seasonality in switching and security. Year-over-year the decline was due to lower enterprise routing and security. For the quarter, service provider was 66% of total revenue and enterprise was 34% of total revenue. Moving on to gross margins and operating expenses.



Non-GAAP gross margins for the first quarter were 62.6%, compared to 63.3% last quarter. Product gross margins were 64.6% of product revenue, up slightly on a sequential basis. As expected, our product gross margins continue to be negatively impacted by product and geographic mix, as well as inventory-related costs. Services gross margins were 56.8%, down nearly 4 points from the prior quarter. This was primarily the result of the reset of variable compensation and an increase in spare parts related to the new product introductions. While the pricing environment continues to be competitive, our strategy remains consistent to differentiate on innovation and focus on cost improvements through our supply chain.

Non-GAAP operating expenses increased sequentially as expected, to \$523 million, driven by typical Q1 increases in employee expenses. Looking at headcount, we ended the quarter with 9,218 employees, a sequential increase of 89, as we continue to hire strategically to support our long-term objectives. Non-GAAP operating margin for the quarter was 12%, due to increased operating expenses and lower gross margins.

Looking at segment contribution margins, which reflect revenues less expenses directly attributable to the segment organization. For PSD, the contribution margin was 37%, and for SSD, contribution margin was 39%. The sequential decline for both segments was primarily due to lower revenue and higher operating expenses. The GAAP tax rate was 30.1% for the quarter. The non-GAAP tax rate was 25.8%, up 2.1 points from the prior quarter. As a reminder, the tax rate shows a sequential and year-over-year increase due to the expiration of the R&D tax credit at the end of 2011.

Looking at the balance sheet, we ended the quarter with \$4.2 billion of total cash and investments. This reduction of \$77 million from the prior quarter is mainly the result of the acquisitions of both Mykonos and the assets of BitGravity. Our net cash and investments was \$3.2 billion. Cash flow from operations was \$102 million. Cash flow is lower sequentially due to the lower income generated this quarter, and was impacted by the semi-annual bond interest payment. DSO was 39 days in the quarter, down from 46 days last quarter, but in line with 38 days in the first quarter of last year. CapEx and depreciation was consistent with prior quarters. We repurchased \$51.6 million, or 2.4 million shares, at an average price of \$21.75. Our policy remains consistent, but over time we aim to offset the dilutive impact of our employee stock programs.

Now I will review our outlook. As a reminder, these metrics are provided on a non-GAAP basis except for revenue and share count. Looking ahead, we will manage the business assuming the near-term environment requires continued caution. We will remain focused on executing our strategy while maintaining a balanced approach for the near and long term.

Given this view, we are expecting revenues to range from \$1.030 billion to \$1.060 billion. Both gross margins and operating expenses for the second quarter are expected to be roughly in line with the first quarter. As a result, we expect operating margins for the second quarter to range from 12% to 14%. We anticipate that operating margins should improve from this level through the rest of the year. This is expected to result in a second quarter non-GAAP diluted EPS of between \$0.15 and \$0.17 per share, and assumes a flat share count and a tax rate of 29%. This tax rate assumes that there is no renewal of the R&D tax credits.

In summary, we will continue to navigate the near term environment carefully. Our new products are gaining momentum as customers see the value of our disruptive innovations. We are focused on disciplined operational execution, driving progress on our new product trend introductions, and investing in critical areas of our business.

I want to thank our fabulous employees for their dedication and hard work. Their commitment to innovation is key to our success in delivering the new network. And with that, I'll hand it over to the operator for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Jeff Kvaal, Barclays Capital.

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**Jeff Kvaal** - *Barclays Capital - Analyst*

I think that we have seen a loft in the overall carrier industry about a slowdown over the last few quarters that, according to their CapEx budgets, included the first quarter. You folks though seem to have been able to manage through that with a seasonably up quarter. What can you tell us about the spending patterns for the rest of the year? Should we be expecting further improvements in your service provider revenues through the year, or is this where we are in caution from here?

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**Kevin Johnson** - *Juniper Networks, Inc. - CEO*

I think first of all, I think it's perhaps a bit too early to outline what we think will happen for carrier capital expenditures for the full year. Obviously we look at the guidance that our large customers provide for capital expenditures and I think there's a couple of things that we observe.

One is that with our large US Tier 1 service providers, in Q1 their capital expenditures were about 21% to 22% of what they've guided for full year, which does show that it's reverting back to a more seasonal pattern that we've seen several years ago, at least with that Q1 number. There are still significant headwinds in Europe and I think that's one that we've seen service providers be very cautious in their capital expenditures.

I think it's still a fairly dynamic environment. I think our focus is going to be clearly on execution. Now, as we've got these new products in market and we're engaging with customers for the architectural design win and the trials to get these products deployed and drive revenue, that's going to be our primary focus. Overall I'd say it's still a bit of a mixed bag and it's too early to call.

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**Operator**

Brent Bracelin, Pacific Crest Securities.

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**Brent Bracelin** - *Pacific Crest Securities - Analyst*

Kevin, I appreciate the innovation agenda and the investments you've made here, but as I look at the expense structure, OpEx as a percentage of sales is now slightly north of 50% of revenue and that's actually the highest in eight years. How should we think about getting a return on those investments, and is this the bottom and we should start to see a more rationalization of R&D expenses going forward? Trying to understand that disconnect between this rise in OpEx that we've seen here, again eight-year high versus getting a good return making sure we're getting a good return on that investment.

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**Kevin Johnson** - *Juniper Networks, Inc. - CEO*

I think it's a very valid question. Certainly, we're at an interesting point in the evolution of the Company in that we just released some very significant products, and so the R&D expenditures for those products are at the peak as we're releasing those, whether it's PTX, T4000. QFabric is an example, and yet the revenue hasn't kicked in on those products. As a result, we end up with an operating expense envelope that's higher as a percentage of revenue than we would like long term. The key for us right now is drive execution on the go-to-market side, and drive that top line revenue to get leverage on the R&D investment.

Now, clearly the operating principles that we've stated for 2012 are clear that we view that Q1 to be the point that we're going to build some operating leverage throughout the year, and much of that has to come from top line revenue. But, clearly, it's up to us to really drive execution in market and translate the investment we've made in R&D to top line revenue and a return for shareholders.

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**Operator**

Brian Marshall, ISI Group.





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**Brian Marshall** - *ISI Group - Analyst*

Looking at the gross margins here I think this is -- gross margins have been headed down six out of the last seven quarters, I believe, and so, I guess the trend is pretty clear. I'm wondering, due to the comments with respect to operating margins coming up in the rest of the year and you just commenting that's largely going to be driven by revenue, should we expect some margin on the gross margin side to expand as the new products ramp at higher margins than current existing product margins? Any color there would be helpful throughout the year.

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**Robyn Denholm** - *Juniper Networks, Inc. - EVP and CFO*

In terms of the gross margins, what I said in my prepared remarks was that actually product gross margins were up slightly quarter-over-quarter, and that was reflective of the slightly higher routing mix in the overall product revenue. In terms of the headline gross margin number at 62.6%, it is a decline quarter-over-quarter but it was mainly the result, in fact primarily the result, of the services gross margin.

What we've seen this quarter with services gross margin, they actually went to 56.8% as a result of the increase in employee expenses typical of the first quarter, but also an increase in spare parts cost as we're bringing the new products to market. Those costs were up quarter-over-quarter.

From an overall gross margin perspective, we expect them to be roughly flat in the second quarter in line with revenue. As we improve or increase the proportion of routing revenue to total revenue for product, the gross margins will increase. Yes, as Kevin said, we're expecting to drive leverage in the model through the top line, but we also are looking at improvements in the product gross margins as we move forward here with the new product introductions, as well.

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**Operator**

Simona Jankowski, Goldman Sachs.

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**Simona Jankowski** - *Goldman Sachs - Analyst*

How do you see QFabric now fitting in within the trend toward self-certifying networking? Also, it seems like some key customers like Google and Verizon are now embracing software to fine networking type technologies as opposed to QFabric. And some of the customer wins you've pointed to seem to be somewhat smaller types of enterprises or hospitals, things like that. Where do you see demand at this point shaping up for QFabric? Lastly on that topic, of the 150 customers you talked about, roughly what percent are deploying the full fabric versus the top of rack solution?

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**Stefan Dyckerhoff** - *Juniper Networks, Inc. - EVP Platform Systems*

Let me start by talking a little bit about the open networking summit, where, actually, my team was well represented. Michael Beesley, our CTO, presented together with one of our customers on the data center side to talk about how we see the use of STN technology in the data center, and for enterprise specifically. When I think about STN, I see a lot of the goals that we've outlined for the new network, in terms of improved economics, experiences, and unleashing innovation on top of the network reflected in the industry movement that is STN.

Certainly, we have been at the forefront of that movement through opening up APIs into our operating system with the Junos SDK, through supporting all of the various technologies that are parts of STN, whether that be open flow or BDPT or PCE, we are going to continue to focus on the programmability as one of the key aspects that we can deliver with Junos.

When you then say, what's the use of that technology in the data center, one of the key things to realize is that virtualization drives the need to reconfigure the network but also drives performance in the network. A flat connectivity between the service is very important for an STN type deployment and certainly, the customers that have adopted QFabric, whether that's Thomson Reuters or whether that's Deutsche Borse or more recently Qihoo 360, have all seen that benefit play out in the physical infrastructure.



Then on top of that, they will make sure that they have the programmability to actually deploy the services on top of that infrastructure. We don't see this as a choice between STN or QFabric. QFabric is part of our new network strategy and programmability is always going to be at the forefront of that strategy, and STN shares some of those goals.

Lastly to your point around the 150 customers, so we have a mix of deployments for the customers that have adopted the QFX product line, they range from top of rack to full fabric. The reason they adopt the product line is because we have strategic alignment with them on the architecture that they want to deploy going forward. The focus for us is to give them a great experience as they adopt the key pieces of technology and there's a good number of them that actually adopt the full fabric, as I mentioned the first two in live deployment as of the first quarter. We're very happy with the progress that we're making there and just continue to focus on execution with the customer engagements.

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#### **Operator**

Ehud Gelblum, Morgan Stanley.

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#### **Ehud Gelblum - Morgan Stanley - Analyst**

Robyn, any color you can give us in terms of the revenue totals in QFabric now that T4000 and PTX, or any kind of bogeys or targets you have for the full year for any of them would be helpful to get a sense as to how they will grow or what percentage they look like right now. Then when you have a QFabric sale, a full QFabric sale like some of the customers you mentioned, can you give a sense as to what percentage of that is top of rack versus what percentage is the inner connect part and the other parts? What I'm trying to get is someone is buying a bunch of top of rack switches but hasn't fully committed yet to the interconnect, have they bought 70% of the solution already or is it only 20% or 30%, and there's that much more to go if you have the interconnect?

Finally on the Edge security side, you said you're working on some features and I think a lot of third parties out there say that you've been losing some share on the Edge and Security side. If you can talk to us about that business and what you can do to restore your position on the Edge and Security will be great.

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#### **Robyn Denholm - Juniper Networks, Inc. - EVP and CFO**

In terms of T4000, PTX revenue and QFabric revenue, we haven't disclosed those and we aren't going to now. They are modest amounts of revenues. Obviously QFabric is growing. It's a couple of quarters now of revenue that is growing nicely. PTX, it was the first quarter of revenue and we're very pleased with the revenue we recorded in the quarter, and as Stefan mentioned, the orders we received for that.

In terms of T4000, the same thing. Obviously we started shipping that late in the fourth quarter, again the first full quarter of revenue and we're pleased with the customer engagements we have on that front. In terms of the ramp of those products, it's too early to call that at this point. We will talk a little bit more about that at the analyst meeting in a few weeks here.

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#### **Stefan Dyckerhoff - Juniper Networks, Inc. - EVP Platform Systems**

If I can just expand on the QFabric part of your question. As we look at the QFabric product line, all of our customers, it's an architectural discussion and we start with whatever they want to start with, whether the top rack they need to deploy as they deploy 10 gig service, they can leverage their investment through taking the on ramp to the QFabric. It's a gradual approach that they can take in order to deploy their capital more efficiently going forward.

Certainly with the distributive nature of top of racks, you've made a good step forward in adopting the full system if you have deployed the top of racks. It will make it significantly simpler. As their businesses dictate that additional performance at the data center, they are going to go do that, but we're very happy with the architectural alignment we have with the customers and the road they are on.



**Kevin Johnson** - Juniper Networks, Inc. - CEO

I'll comment on the third part of your question, specifically on security. I think this was a strong quarter for us with the SRX. I think it was roughly within a million of the highest quarter we've had of SRX revenues. It reflects the strength that we're seeing in the scenarios for service provider and I think we've been very transparent that the work we're doing around our security designer software, which is basically software that is the user interface for configuring and managing these security devices in the enterprise.

We had an initial release of that software in Q1. We've got further releases coming throughout the year. We've been very open with our customers. The focus that we have in many ways on our security agenda is to really address the opportunity to improve the user interface and user experience for enterprise customers as they configure and manage these security devices. We're seeing good response thus far in the quarter from the work that we've done, and we've got a good road map and I think at the financial analyst meeting we'll provide a deeper dive on the overall end-to-end security strategy.

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**Operator**

Rod Hall, JPMorgan.

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**Rod Hall** - JPMorgan Securities Inc. - Analyst

Robyn, to clarify your comment on operating margin to make sure I've got it. You're saying that operating margin will increase sequentially each quarter going forward, or that it will just be higher in future quarters than it is now? Just wanted to clarify that. Second thing I wanted to ask was on the APAC revenue decline, if you guys could get any color on that. I saw it was down 12% year-over-year so just any color on what's happening there, anything specific. Circling back to that comment on revenue proportion and so on, the T4000, I'm just curious if you could give us any idea, would that be the majority of routing revenue as you exit the quarter, of Core routing revenue that is, as you exit the year, I mean, or is that more of a 2013 event when that becomes the majority of Core routing revenue?

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**Robyn Denholm** - Juniper Networks, Inc. - EVP and CFO

In terms of operating margin, what I said in the prepared remarks is for Q2 we'll be somewhere between 12% and 14% reflective of the flat to up revenue with similar gross margins and similar OpEx to the first quarter. Our operating principle is to expand operating margin through the year, and so we're very focused on that, as Kevin mentioned and as I mentioned in my prepared remarks, in terms of continuing to drive revenue growth and continuing to drive operational efficiencies across the Company, as well.

In terms of APAC, what I talked about in my prepared remarks, and then maybe Kevin would like to comment as well, was that we did see year-over-year decline. The primary reason for that is Q1 of last year, which was pre-tsunami. If you remember tsunami was 3/11. We actually had completed in the first quarter a large service provider deployment in Japan. We talked about that at the time, and so our year-over-year comparisons were very high for Q1 of last year, and so that was the year-over-year decline story in Japan. We did see a sequential increase in service provider demand in Japan, which we were pleased about.

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**Kevin Johnson** - Juniper Networks, Inc. - CEO

I think we saw an opportunity in China that pushed out of Q1 that we're still focused on. I think as Robyn said, we've got a very good Service Provider business in Japan and relationship in Japan, but we have an opportunity in Japan to diversify our customer base and expand beyond the set of service providers into other service providers and into more enterprise customers through our partners in Japan. I look at the emerging market opportunities that we have in China and India and how we continue to drive execution and diversifying the customer base in Japan.

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**Stefan Dyckerhoff** - Juniper Networks, Inc. - EVP Platform Systems

Let me finally comment on some of the new products. With our newest release of Junos, we support the T4000, the MX upgrades, as well as the PTX. So, as we look at customer qualifications for those, the PTX contributed minimal revenue in the quarter, and we see a qualification time that is in the 9 to 12 month range typically for such a new system. Then from there, customers will move to deployment.

On the T4000, had a slightly higher revenue contribution in the quarter, and we would expect the qualification times to be in the six to nine month range for that type of upgrade. Again, customers will deploy the capital prudently as they move through the year, once they have the system qualified. Last but not least on the MX, we saw good uptake on the MX upgrades in the quarter as we enabled those with our new release of Junos, and we're optimistic about the traction of those upgrades as we move through the year.

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**Operator**

Nikos Theodosopoulos, UBS.

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**Nikos Theodosopoulos** - UBS - Analyst

Stefan, the service provider router market last year grew below 10% after many years of growing stronger double digits. Do you think we're in a new secular growth rate in routing or do you think we can recover back to that double digit strong double digit growth rate?

Then Kevin, a question for you. The Company goals had been 20% revenue growth, 25% operating margin. Do you see those goals as still achievable? Obviously, this year wouldn't be the case, but do you still see those as targets or do you feel new targets need to be established for the Company?

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**Stefan Dyckerhoff** - Juniper Networks, Inc. - EVP Platform Systems

On router growth, I think what we're seeing overall is that certainly IP technology is a bigger and bigger portion of what drives the Business for service providers. However, as Kevin mentioned, we think service providers are going to continue to be cautious with their CapEx and that applies to all areas of the Business. I think it's a little bit too early to call the market growth for the rest of the year.

Certainly, as we work with our service provider customers and we see their plans for deployment of capital towards the markets we address, I think we're in a very good position but the overall environment for service provider CapEx is something that will remain somewhat uncertain throughout the rest of the year, as we stated.

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**Kevin Johnson** - Juniper Networks, Inc. - CEO

Yes, Nikos, I'll take your second question and refer back to the operating principles that we've stated for 2012. I think your first question on what will addressable market do in growth is a relevant question, because one of the operating principles we have is we have to drive to grow faster than the market. When markets expand faster that gives us more opportunity to grow. When they expand slower -- We do think we're in a growth market, but frankly, the focus is going to be, as the operating principle states, which is growing faster than the market.

The second part of your question is, the way to drive operating leverage on the Op margin is to drive the top line revenue by monetizing this great set of new products that we've just released in the marketplace. We've been working hard for a number of years on these products, the silicon that goes into these products, the systems and the software put together with an architectural approach. And now that we have these products in market, it's up to us to really drive execution and monetize that investment that we've made in R&D. The operating principle that states growing and expanding the operating margin from Q1 combined with the operating principle without growing faster than the market would be the guiding principles. Robyn, anything else you want to add?



**Robyn Denholm** - Juniper Networks, Inc. - EVP and CFO

No, I think that's good. In terms of absolute numbers and that type of thing in terms of the model, we're obviously not putting out a new model at this point. We're talking about the operating principles and growing faster than the market in this environment.

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**Operator**

Mark Sue, RBC Capital Markets.

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**Mark Sue** - RBC Capital Markets - Analyst

Kevin, can you share your observations of service provider orders on a month-to-month basis? I ask since Verizon was one of the first carriers to fall off and is now one of the first to return. Does your order flow point to a return to a cycle recognizing some Europeans are still weak, is there deterioration, or just caution which implies that time frame for a return? Routers, if we do return to a cycle, can we still get to 68% gross margin? I understand a lot of that is mix related, but do you feel that there's a structural drop in margins for the router market?

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**Kevin Johnson** - Juniper Networks, Inc. - CEO

In the service provider marketplace, the observation that I would have is there's certainly, in Europe, there's a geographic commonality that's impacted by the macro situation in Europe that creates a certain pattern of cautiousness on those service providers. In other service Providers it's on a case-by-case basis.

It depends on where they are in the project cycle and how they prioritize things. In some cases, as they're growing their mobile internet business, they may have one set of priorities and then shift to other priorities. There's not a common pattern that you see across all of them, but the one thing that is common is certainly they've built their business around delivering value to their customers in the form of networks and those networks are transitioning to IP packet switch networks which creates opportunity for us.

That is the one commonality that I see in service providers, but there's not some common pattern, your question was month-to-month. There wasn't some common pattern that would say fit all service providers. There's some geographic and then it is case-by-case depending on the customer situation.

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**Robyn Denholm** - Juniper Networks, Inc. - EVP and CFO

Yes, Mark in terms of the gross margins, in the near term as I said before, we do expect the gross margins to stay in this range. For Q2 we believe they will be roughly flat with the first quarter, reflective of some modest increase at the high end and in terms of revenue, but the gross margins will be roughly the same.

In terms of competition and pricing and that type of thing in the marketplace, we obviously are in a competitive market. We have been for a long period of time. Our strategy is very clear, though. We deliver innovation to the market, which drives tremendous efficiencies in CapEx and also in OpEx for our customers. That is our main focus in terms of delivering the innovation to market. And we will continue to work on the gross margin structure, both in terms of the cost side but also as the mix of products increases, particularly with the new products, we'll see gross margins increase, as well.

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**Operator**

Paul Silverstein, Credit Suisse.



**Paul Silverstein** - *Credit Suisse - Analyst*

Robyn, can you comment on the pricing environment relative to what you've seen in the past? Secondly, in terms of your guidance, we're looking at flat up \$30 million depending upon if you were to comment within the range. Kevin or Robyn, can you comment on what the different drivers of that guidance, in terms of the ramp of the new products, and I recognize we're talking about a very small base of business at this point for those new products, but if you could comment on your expectations of the existing Business in terms of growth or decline versus the growth in the new products that gets you to that guidance, that would be appreciated.

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**Robyn Denholm** - *Juniper Networks, Inc. - EVP and CFO*

Yes, in terms of the revenue guidance for the second quarter, we are looking at flat to slightly up in terms of revenue overall. In terms of the sectors what we're anticipating is, obviously, flat to slightly up from a service provider perspective and also from an enterprise perspective given the current environment. In terms of the overall gross margins, I think you talked about, sorry it was pricing, I miss wrote that.

The pricing environment as I mentioned in the last question on gross margins, it's obviously a competitive environment. It has been for quite some time in terms of the market dynamics but it hasn't changed our philosophy in terms of delivering innovation to the market and total cost of ownership for our customers. As Kevin's mentioned before, on the earnings calls, we will compete on price to win new customers on a selective basis. We will continue to do that on a selective basis, particularly as it relates to extending our rates into certain customers in certain markets and geographies but overall, the market environment is pretty consistent with what its been over the last number of quarters.

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**Operator**

Tal Liani, Banc of America.

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**Tal Liani** - *BofA Merrill Lynch - Analyst*

Just clarification on gross margin. If revenues go back today, this quarter they would have been back at their historical levels, let's say, of last quarter, last year's first quarter. Would margins be in the same level or is there an impact of pricing and the aggressiveness of competitors? I just couldn't understand this part.

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**Robyn Denholm** - *Juniper Networks, Inc. - EVP and CFO*

Yes, it's a mix of product was similar to the mix of product of Q1 of last year, the gross margins would have been similar to what they were a year ago. There wouldn't be that big of difference, in terms of the line items of gross margins on the individual products are pretty consistent with where they were a year ago. That's why, in terms of my discussion on the call, it is still mainly the result of product mix with our routing proportion of revenue being relatively low compared to historic leverages.

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**Operator**

Tim Long, Bank Montreal.

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**Tim Long** - *BMO Capital Markets - Analyst*

A question on visibility. Maybe if we could go back to the March quarter, pretty meaningful beat there and I know, Robyn, it's a tough environment, and also you mentioned the orders from Q3 hitting. Could you give us a sense as to how much of that, whether it was \$50 million or \$60 million of revenue beat, was due to previous orders and how much of that was in the quarter? Secondly, when you look into the second quarter, has



visibility improved or not and is there any deals that had been previously signed that will continue to contribute into the second quarter like they did in the first quarter?

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**Robyn Denholm** - Juniper Networks, Inc. - EVP and CFO

In terms of Q1, Q1 pretty much unfolded as we were expecting. Obviously slightly better with our large US service provider customers, so slightly better. But basically, the quarter unfolded as we expected it to unfold.

In terms of our visibility as we go into Q2, it's about the same. We have, obviously, product book-to-bill for Q1 was just under 1. We exit Q1 with slightly less backlog than we entered the quarter, but that's typical of the first quarter and actually we're pretty pleased with the backlog that we have going into the second quarter. Our deferred revenue from a product perspective is essentially flat sequentially.

We've got visibility to the balance sheet, as well and we also, obviously, continue our dialogues with customers, not just about the new products but existing products and design wins that we've worked with them on, and other customer opportunities. In terms of visibility, it's about the same as it was coming into the first quarter, no better, no worse than 90 days ago.

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**Operator**

I would like to turn the floor back over to management for closing comments.

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**Kathleen Nemeth** - Juniper Networks, Inc. - VP - IR

Thank you, Operator, and we would like to once again thank you all for joining us today and we hope to see many of you at our financial analyst meeting here in Sunnyvale in June.

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**Operator**

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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