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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Jess Ian Lubert *Juniper Networks, Inc. - VP of IR*

Kenneth Bradley Miller *Juniper Networks, Inc. - Executive VP & CFO*

Rami Rahim *Juniper Networks, Inc. - CEO & Director*

CONFERENCE CALL PARTICIPANTS

Alexander Henderson *Needham & Company, LLC, Research Division - Senior Analyst*

Amit Jawaharlaz Daryanani *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Atif Malik *Citigroup Inc., Research Division - Director and Semiconductor Capital Equipment & Specialty Semiconductor Analyst*

David Vogt *UBS Investment Bank, Research Division - Analyst*

George Charles Notter *Jefferies LLC, Research Division - MD & Equity Research Analyst*

James Edward Fish *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Karl Ackerman *BNP Paribas Exane, Research Division - Research Analyst*

Meta A. Marshall *Morgan Stanley, Research Division - VP*

Michael Ng *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Samik Chatterjee *JPMorgan Chase & Co, Research Division - Analyst*

Simon Matthew Leopold *Raymond James & Associates, Inc., Research Division - Research Analyst*

Tal Liani *BofA Securities, Research Division - MD, Head of Technology Supersector & Senior Analyst*

PRESENTATION

Operator

Greetings. Welcome to Juniper Networks Q3 2023 Financial Results Conference Call. (Operator Instructions) Please note this conference is being recorded.

I will now turn the conference over to your host, Jess Lubert, Head of Investor Relations at Juniper. You may begin.

Jess Ian Lubert - *Juniper Networks, Inc. - VP of IR*

Thank you, operator. Good afternoon and welcome to our third quarter 2023 conference call. Joining me today are Rami Rahim, Chief Executive Officer; and Ken Miller, Chief Financial Officer.

Today's call contains certain forward-looking statements based on our current expectations. These statements are subject to risks and uncertainties, and actual results might differ materially. These risks are discussed in our most recent 10-Q, the press release furnished with our 8-K filed today, the CFO commentary posted on the Investor Relations portion of our website today and in our other SEC filings. Our forward-looking statements speak only as of today, and Juniper undertakes no obligation to update any forward-looking statements.

Our discussion today will include non-GAAP financial results. Reconciliation information can be found on the Investor Relations section of our website under Financial Reports. Commentary on why we consider non-GAAP information a useful view of the company's financial results is included in today's press release. Following our prepared remarks, we will take questions. (Operator Instructions).

With that, I will now hand the call over to Rami.

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Good afternoon, everyone, and thank you for joining us on today's call to discuss our Q3 2023 results. We delivered better-than-expected results during the third quarter with total revenue of $1.398 billion, exceeding the midpoint of our guidance. Profitability was also strong in Q3 as our non-GAAP gross and operating margins both exceeded expectations, resulting in non-GAAP earnings per share of $0.60, which was above the high end of our quarterly guidance range.

Our teams continue to execute well against the backdrop of a challenging macro environment. We remain confident in our positioning from a technology perspective and our ability to win across industry verticals as customers increasingly look to leverage AIOps and software automation tools to improve network operations and reduce overhead costs, what we call Experience-First Networking. We believe our attention to providing customers with the best user experience, along with our continued go-to-market focus, will position us to deliver healthy long-term growth and improved profitability.

Total product orders came in largely as expected during Q3, and the rate of year-over-year order decline improved as compared to the prior few quarters. Our Enterprise business remained healthy as orders experienced high single-digit sequential growth and exceeded our expectations. Enterprise strength helped offset order weakness with our Cloud and Service Provider customers, where we continue to see accounts digesting prior purchases before placing new orders.

I'm extremely encouraged by the momentum we're seeing in our Enterprise business, which once again delivered record revenue results and accounted for more than 50% of total revenue for the first time in Juniper's history. Total Enterprise revenue grew by nearly 40% year-over-year in the Q3 time frame and represented our largest and fastest-growing vertical for our fourth consecutive quarter.

Importantly, new logos saw another quarter of healthy double-digit growth, and we continue to see strong mid-market success as enterprise deal registration through the channel grew by more than 20% year-over-year and commercial orders grew by nearly 20% year-over-year. We believe continued growth in new logos and mid-market strength speaks to the differentiation of our products and our ability to capture share.

Our campus and branch business had another record quarter in Q3 with our AI-Driven Enterprise revenue growing more than 40% year-over-year. Revenue from the Mystified segment of our business, which consists of products driven by Mist AI, also had a record quarter, growing by nearly 100% year-over-year in the Q3 time frame. Our Mystified orders also achieved a notable milestone in Q3, surpassing $1 billion run rate on an annualized basis less than 4 years after crossing the $100 million run rate milestone in Q4 2019.

Customers and the industry are recognizing Juniper's clear and defensible leadership when it comes to AI-driven operations delivered via a modern microservices cloud and the meaningful benefit these solutions can provide in terms of reducing network trouble tickets, automating manual tasks, speeding time to deployment and reducing mean time to repair as compared to competitive platform.

We see these benefits resulting in share gain opportunities as customers transition from legacy on-prem solutions managed by people to next-gen solutions managed using AI and the cloud. We believe this architectural transition remains in the early innings and will represent attractive growth opportunities for years to come.

In Q3, we secured a win with a global pharmaceutical leader, the world's largest health care provider added to its Juniper Mist rollout, and 2 very large retailers extended their Juniper Mist network to include our full stack across WiFi, wired and SD-WAN. One of these retailers is approaching 10,000 locations.

Initial demand for our cloud-based network access control product was also strong, securing more than 50 customer wins in a little more than a quarter of availability with customers highlighting dramatic reductions in rollout time from days to minutes and simplified operations as being key differentiators.

Mystified's strength was broad-based across the portfolio with record Wireless, Wired and SD-WAN revenue in the quarter as well as record full-stack wins, where customers purchased several of these campus and branch products together. We view momentum with these full-stack wins as a positive forward indicator given our belief that for every dollar of wireless, there is $2 to $3 of wired switching and additional SD-WAN and NAC opportunity.

Our Enterprise data center business also performed well in Q3 with Apstra continuing to see strong momentum in the market. Apstra new logos grew by more than 80% year-over-year in Q3, and the pipeline of opportunities remain solid. Hardware pull-through for every dollar of Apstra software has been meaningful and growing, which we view as a positive forward indicator for our data center prospects.

Key data center wins in the quarter for Apstra and our QFX switch offerings included large government agencies, international Tier 1 service providers and one of the largest global appliance manufacturers. The performance of our Enterprise business shows our diversification strategy is working. And given our level of portfolio differentiation balanced against our relatively modest share in the large markets where we compete, I expect us to grow our Enterprise revenue and orders in 2023 and 2024 even in a more challenged macro environment.

As highlighted over the last few quarters, we continue to see accounts across each of our customer verticals more closely scrutinizing budget and project deployment time line due to the macro uncertainties that are happening around the world. This has been particularly true in the Cloud vertical, where many of our customers are still in the process of digesting prior purchases.

While these dynamics are likely to pressure our Cloud segment for at least the next few quarters, we remain optimistic regarding our longer-term prospects in the Cloud. Our optimism is driven by our strong wide-area footprint, the rapid traffic growth that continues in many of these customers' environments and the opportunity to capitalize on the adoption of large language model and the build-out of AI clusters, where we are seeing strong customer engagement that is driving optimism regarding our opportunity to benefit as the industry increasingly considers Ethernet as the right choice for a wide array of AIML use cases, including front-end, back-end, inference and storage networks.

As I mentioned last quarter, we expect AI adoption to drive a meaningful uptick in traffic growth that is likely to benefit our Cloud wide-area footprint over time. We also remain optimistic regarding our AI data center switching opportunity where we are already seeing success with Cloud Major and Enterprise accounts due to the performance and power efficiency of our custom silicon, the congestion management capabilities embedded within our Junos operating system and our support for technologies such as RDMA networking.

Additionally, by incorporating Apstra in our AIML design, Juniper differentiated in its ability to deliver the turnkey deployment and reliable operations of AIML clusters, which is critical to achieving the performance goals required by AIML team. Our service provider business softened in Q3 and was impacted by some of the macro uncertainties that are happening around the world. These dynamics are causing many carriers to more closely scrutinize budgets and, in some case, to run their networks harder than planned. We found this to be particularly true amongst our Tier 2 and Tier 3 customers as well as certain large international accounts, while activity with the U.S. Tier 1 operators has largely tracked according to plan.

Despite these macro headwinds, we remain encouraged by the momentum we're seeing in our Cloud Metro portfolio where our new ACX7000 platform had a record revenue quarter and saw solid year-over-year growth from an orders perspective. These products secured 6 new footprint wins in the Q3 time frame, including a win with an international Tier 1 account. We expect this business to build through the remainder of the year and become more material to revenue in the 2024 time frame and beyond.

I'd like to highlight that our services team continued to execute extremely well and delivered another quarter of record revenue and margins during the Q3 time frame. Services account for more than 35% of our total revenue and we believe represents an underappreciated aspect of the business that is not only recurring and likely to grow in the years to come, but also presents opportunities for margin expansion as the team continues to identify and capture efficiencies.

In summary, while the macro environment remains uncertain and is impacting our near-term outlook, I remain confident with our strategy and optimistic regarding our long-term growth prospects. My enthusiasm is fueled by our continued Enterprise momentum and the attractive longer-term opportunities we continue to see in the Cloud as well as Service Provider metro opportunity.

I'd also like to emphasize that we remain committed to delivering improved profitability and still expect to deliver greater than 100 basis points of non-GAAP operating margin improvement in 2023. We also expect further improvement in 2024. While we view revenue growth as the primary lever to achieving improved profitability and reducing costs is never easy, we recently announced an action to protect profitability while preserving investments in strategic areas of the company.

I will now turn the call over to Ken, who will discuss our quarterly financial results and outlook in more detail.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Thank you, Rami, and good afternoon, everyone. I will start by discussing our third quarter results then provide some color on our outlook. We ended the third quarter of 2023 with $1.398 billion in revenue, which was over $10 million above the midpoint of our guidance. We delivered non-GAAP diluted earnings per share of $0.60, which was $0.01 above the high end of our guidance range, driven by better-than-expected revenue results and improved gross and operating margins.

Total product orders came in largely as expected, and the rate of year-over-year decline improved as compared to the prior few quarters. Enterprise demand continues to be strong and exceeded our expectations, resulting in orders that grew in the high single digits on a sequential basis but were approximately flat year-over-year. Cloud and Service Provider demand remained pressured due to digestion of previously placed orders and an unfavorable macroeconomic environment.

From a customer solution perspective, on a year-over-year basis, AI-Driven Enterprise led the way with record revenue and growth of 43%. Automated WAN solutions revenue declined 18%, and Cloud-Ready Data Center revenue declined 26%.

Looking at our revenue by vertical. On a year-over-year basis, Enterprise increased 37%, Service Provider declined 20%, and Cloud decreased 28%. Total software and related services revenue was $313 million, which was an increase of 27% year-over-year. ARR was $357 million and grew 37% year-over-year. Deferred revenue from our SaaS business grew more than 50% year-over-year. We remain confident in our software transformation and ARR growth.

Total Security revenue was $160 million, up 14% year-over-year. Our Services business remained strong in Q3, posting record revenue and profitability. Service revenue was $500 million and grew 12% year-over-year and 7% sequentially. Non-GAAP Service gross margin of 72.8% improved 4.8 points versus a year ago and 3.1 points sequentially. We see the potential for continued Services revenue growth and improvements in profitability.

In reviewing our top 10 customers for the quarter, 5 were Cloud, 3 were Enterprise and 2 were Service Providers. Our top 10 customers accounted for 29% of total revenue as compared to 34% in the third quarter of 2022. Non-GAAP gross margin was 59.5%, which was at the high end of our guidance range. This was primarily driven by the improved Service margin, favorable software revenue mix and lower logistics costs, which was partially offset by higher inventory-related expenses.

Non-GAAP operating expenses increased 4% year-over-year primarily due to head count-related costs but were down 1% sequentially. Non-GAAP operating margin was 17.5% for the quarter, which was above our expectations, primarily driven by better-than-expected gross margin. Cash flows from operations were $329 million.

We paid $70 million in dividends, reflecting a quarterly dividend of $0.22 per share. We also repurchased $125 million worth of shares in the quarter. We exited the third quarter of 2023 with total cash, cash equivalents and investments increasing to $1.4 billion. Lastly, we incurred an aggregate amount of $62.5 million in restructuring charges in the third quarter of 2023 in connection with the plans to reallocate resources to efficiently support our strategic priorities while delivering against our profitability goals.

As disclosed in 8-K filed earlier this month, we announced a plan to reduce worldwide head count by approximately 440 employees, resulting in the majority of this restructuring charge. Please reference our SEC filings for more information. Overall, we delivered solid results in the third quarter, and I'm pleased with our team's dedication and commitment.

Now I would like to provide some color on our guidance, which you could find details in the CFO commentary available on our Investor Relations website. The macroeconomic environment is expected to remain challenged, which has been factored into our outlook.

For the fourth quarter of 2023, we expect to see sequential growth in bookings and expect the rate of year-over-year order declines to further moderate. We continue to see healthy Enterprise momentum and expect orders to grow both in the fourth quarter and on a full year basis. However, we expect demand from Cloud and Service Provider customers to remain constrained as they continue to digest previously placed orders.

Non-GAAP gross margin is expected to modestly increase in the fourth quarter of 2023 to approximately 60% due to expected lower supply chain costs. We will continue to manage non-GAAP operating expenses prudently and expect a sequential decline of approximately $10 million.

With our fourth quarter guidance, total 2023 revenue is expected to grow approximately 5% to 6% on a full year basis, and non-GAAP operating margin will expand by more than 100 basis points. Additionally, non-GAAP earnings per share are expected to grow double digits in 2023, meeting our previously stated guidance for revenue and profitability.

While the current global macroeconomic environment poses some uncertainty, we would like to provide some initial color regarding our current outlook for 2024. Bookings across all verticals are expected to grow next year on a full year basis. We expect our Enterprise revenue to grow. However, total revenue results will depend on the rate and pace of recovery in our Cloud and Service Provider verticals, which remain uncertain at this time.

Based on our current order expectations and backlog levels, we expect a return to more traditional seasonal revenue patterns beginning in the first quarter of 2024. As a reminder, prior to the industry-wide supply chain shortage, we historically experienced double-digit sequential revenue declines in the first quarter followed by sequential revenue growth throughout the remainder of the year.

We expect non-GAAP gross margin to expand in 2024. We will continue to manage non-GAAP operating expenses prudently and expect non-GAAP operating margin expansion in 2024. However, our ability to achieve this objective will be partially dependent on revenue results. Our long-term financial objectives have not changed. We plan to deliver sustainable revenue growth, improved operating margin and earnings expansion over time. Finally, I'm pleased to announce we have declared a quarterly cash dividend of $0.22 per share to be paid this quarter to stockholders of record.

In closing, I'd like to thank the Juniper team for their continued dedication and commitment to Juniper's success, especially in this dynamic environment.

Now I'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question today is coming from Amit Daryanani from Evercore.

Amit Jawaharlaz Daryanani - *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*

Good job on the margins over here, fairly impressive. My question is really around the decrease you're seeing on the Cloud and Service Provider market in aggregate. I'm really curious if you've seen any change in tone over the last 90 days because a lot of the stuff you saw that you talked about last quite as well. And maybe across both the segments, is your sense that the weakness is coming more from customers having to digest the product they already have? Or is it more because they're pushing out new deployments? I'm curious how this starts across the segments. And then maybe related to this mega segment, from a historical perspective, how long do you think is correction typically last and perhaps that answers a little easy on Service Provider versus Cloud but (inaudible) what the historical perspective looks.

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Amit, this is Rami. I'll start. For some reason, you're really choppy. So I hope the issue is not on our end. I think I got most of what you asked really around the demand environment that we're seeing for Cloud and SP, and I think you're looking for some commentary around sort of the duration of that -- the challenges that we're seeing in that segment.

I'd say, first, not much has changed from the last quarter in terms of what we're seeing in SP and Cloud. Service Provider is probably incrementally more challenging as I mentioned in my prepared remarks, not so much because of Tier 1 service providers in the U.S., more about Tier 2, Tier 3 and international.

Cloud is challenging as we expected. I don't think it's gotten worse or better, really. And we've always expected that the digestion period that is being faced in the Cloud and, to some extent, in the Service Provider vertical as well, is going to last for several quarters.

Having said that, I don't think it's all negative. I mean in the Service Provider space, for example, there are plenty of opportunities out there that we're competing for, especially in the Metro, where we're seeing really great early momentum. And I expect that that's going to more meaningfully contribute to our top line next year.

In the Cloud provider space, there are projects that are ongoing. We're competing for new projects for certain. The AI cluster opportunity is going to emerge, as I think, a wonderful opportunity for us to go and to pursue. I just think it's going to be a few more quarters of digestion before those opportunities start to play out and we begin to benefit from them.

Operator

The next question is coming from Michael Ng from Goldman Sachs.

Michael Ng - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I just have two. First, I was just wondering if you can talk a little bit more around the strength in Hardware Maintenance and Professional Services. Very good quarter-on-quarter growth. Was there something that may have helped on the maintenance side, whether it's the incremental challenges in SP that you talked about that may have led to more maintenance?

And then the second, I was just wondering if you could talk a little bit more about product orders. It's encouraging to hear that it was in line with expectations and the year-over-year decline improved. But how much did product orders actually decline in the quarter?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. So I'll take those questions. So on the Services side, very proud of the team. And we've seen some record services result both on the revenue side, up 12% year-on-year, as well as on the margin side. So really phenomenal results there.

The services business does include predominantly our Maintenance Professional Services business, but it does include a growing portion of our SaaS software, which has been growing faster than the overall services results. So the SaaS business is absolutely helping services overall.

But as you look at just the Maintenance business, which is what you talked about and the growth there, really, there's a lagging indicator of what we've seen in the past couple of years on the product side. So the product growth over the last couple of years has really given us the opportunity to expand our installed base and to attach more service contracts, and we're realizing the benefit of that now. So that's been great.

On the product booking side and the order side, it did come in as we expected. Enterprise was maybe a little more favorable than we originally anticipated at the start of the quarter. Service Provider was a little bit weaker than we anticipated, but in aggregate, it was as expected. And as we predicted, we are starting to lessen that year-over-year decline that we've had in the last couple of quarters, and I expect us to further lessen that decline here in the fourth quarter.

Operator

The next question is coming from Samik Chatterjee from JPMorgan.

Samik Chatterjee - *JPMorgan Chase & Co, Research Division - Analyst*

I guess if I start on the margin front, you're guiding to operating margin expansion, although with the sort of caveat about what that revenue outlook looks like. I do see you sort of expanding gross margins next year. So can you just outline what are sort of the sort of puts and takes here? What is the amount of revenue decline you can absorb even with gross margin expansion and still sort of deliver operating margin expansion as you look to next year?

And just a quick clarification on Michael's question here. So you said orders have tracked in the quarter largely in line, but you seem to be moderating your 4Q order trajectory of saying now it's maybe a more modest decline where earlier you were saying it's an increase as of the last quarter or so. There seems to have been an incremental change there even though it tracked in line in the quarter. Can you just clarify what led to that change?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Absolutely. So this is Ken. On the margin expansion for next year, which we are anticipating, we are going to -- we are expecting a gross margin improvement next year. We also -- we will be -- continue to be prudent on cost controls. So with the gross margin expansion as well as the prudence on cost controls, we do believe we will expand operating margin.

That really would apply to revenue at, say, modest decline levels. If revenue declines were to get larger than that, it would be more challenging. But we would stay laser-focused on protecting profitability. And if necessary, we would consider taking further costs out of the business to protect our margins.

On the Q4 order perspective, you're right, in prior quarters, we did mention we thought we will return to year-on-year growth potentially as soon as Q4. We still might return to year-on-year growth in Q4. Quite confident that the year-on-year decline, if there is one, will be significantly lessened from the last couple of quarters. But we may return to year-on-year growth in Q4, but it's not factored into my current base case. I do expect us to return to full year growth or year-over-year growth in 2024, early in 2024. And on a full year basis, in 2024, I would expect all verticals to have full year growth.

Operator

The next question is coming from Alex Henderson from Needham.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

I was hoping you could give us some sense of when you think some things are going to normalize. And most specifically, the -- when -- at what juncture do you think your backlog is fully normalized? And at what juncture do you think your excess inventory will normalize? I assume that's with a lag to the backlog. And do you think that there's any risk within that inventory as we're going through these delays and changing environment? Is there anything in your inventory that you think might be an obsolescence problem?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Good questions. On the backlog front, backlog has come down faster or normalized faster than we expected this year largely because the supply chain has actually improved much quicker than we expected from a lead time perspective. So we have seen backlog come down. I expect it to continue to come down in the fourth quarter as well.

I still believe we will remain -- we'll exit the year at an elevated backlog position. But at this point, I do not believe it will be 2x the elevated position that we've been talking about in prior periods. So I think it will be elevated but not quite 2x. I do expect backlog to fully normalize probably by the middle of next year. I would say probably the first half to the middle of next year, backlog should be kind of fully normalized.

Inventory has been growing throughout the last couple of years. I would expect this to plateau and start to come down at some point in 2024. It is going to take longer, to your point, the inventory kind of normalization, if you will, it's going to take a few years, in my opinion. And I don't think we'll ever get down to previous normals, right? I think we've learned some lessons with the recent supply chain situation. I think we'll continue to carry inventory at higher levels than we historically did, but there is still a fairly sizable room for it to reduce over the next few years.

And on the cost of that inventory, there are costs. I mean I mentioned in the gross margin guidance, we had a very strong gross margin quarter really highlighted by software, services. And we are seeing some of the earlier transitory costs, i.e. logistics and expedite fees, come down. But some of the goodness in gross margin was offset by an increase in inventory-carrying charges. That would include excess and obsolescence reserves as well as just carrying charges.

So we are paying for those now. That's factored in, obviously, to our results and to our near-term and longer-term guidance. I do think there's opportunity for those to reduce over time as inventory starts to normalize.

Operator

The next question is coming from Simon Leopold from Raymond James.

Simon Matthew Leopold - *Raymond James & Associates, Inc., Research Division - Research Analyst*

First, just a quick clarification, if I may. In your prepared remarks, you talked about a return to normal seasonality in 2024, and you also made a reference to Q1 being down double digits in the past. Are we to take it that you expect Q1 '24 to be down by a double-digit rate? That's a clarification, simple.

In terms of the broader question, however, I see a number of the third-party market research firms expect the campus environment, both wireless LAN and campus switching, will decline in 2024. And you've been experiencing some good growth here. I assume it's decelerating, but you sound very confident that you'll still grow. Could you help us unpack what separates your view from the market research firms?

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Thanks for the question, Simon. I'll start with your second question first, and I'll then hand it over to Ken. So first, you're right, I am confident in our campus and branch business. We have grown over the last few years even in the face of pretty significant headwinds. At a time when, for example, in the middle of COVID where some of our peers were seeing some declines, we consistently saw growth in our campus and branch business.

I think the solutions that we're offering that include AIOps that simplify and reduce the cost of operations actually truly resonate with customers that are looking for executing on digital transformation projects in a situation where their budgets are challenged, right? We're basically enabling them to transform their business with less total cost of ownership. That's part of the value proposition of our solutions that's really resonating.

In addition to that, the campus and branch market all up if you include Wired, Wireless and WAN is a $25 billion market opportunity, give or take, of which we're a small player and plenty of room for us to grow, even in the face of a total addressable market that's not growing all that much or even not even growing at all. So for all of these reasons, I'm super optimistic about our Enterprise business and especially our campus and branch business looking forward.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. And on your clarification question, the short answer is yes, I would expect a sequential decline from Q4 to Q1 in that double-digit realm based on kind of previous traditional patterns.

Operator

The next question is coming from David Vogt from UBS.

David Vogt - *UBS Investment Bank, Research Division - Analyst*

I'm going to kind of bundle a couple of things here, all related, if you may -- if you let me. So I'm trying to understand sort of the seasonal patterns of the business that you referenced going into Q1 and then sequentially getting stronger because the business is a little bit different today than it was pre-COVID, right? Mist is much stronger, and I would imagine the severity of the decline in Cloud is much deeper than you would have anticipated.

So, I guess, the first question is, does the normal seasonal patterns hold? Or is there some sort of variability around the normal seasonal patterns in the years prior to COVID? And then in conjunction with that, I think you said backlog should get normalized by the end of the second quarter. Does that mean you're expecting roughly $300 million, $400 million, maybe $500 million of revenue from backlog in the first half of 2024 to show up as revenue? And then I have a follow-up.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. So I'll address the seasonal pattern one. We do expect the double-digit decline Q4 to Q1 as we mentioned. And then from there, we expect sequential growth throughout the rest of the quarter.

I would say we've talked a lot about revenue next year was uncertain predominantly because it's just unclear about the pace and timing -- the size and timing of the recovery within Cloud and SP. So that implies to me that we expect it to recover at some point next year but just not exactly sure when. And when that does, that should accelerate revenue.

So I would expect revenue to be maybe a bit more back-end loaded, probably closest traditional patterns this last year, 2023 or this year. 2023 was not kind of a sequential growth quarter. It was kind of a flattish quarter from a quarter-to-quarter perspective throughout the year. Next year, I think we'll start down and it will build back up as the year progresses.

David Vogt - *UBS Investment Bank, Research Division - Analyst*

And then on the backlog because it sounds like it's going to be normal after the end of the second quarter. So that sounds like it would be a pretty healthy tailwind despite sort of the commentary for sequential pressure in the first quarter. So I just wanted to clarify that.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. So backlog continues to be a bit of a tailwind in each of our quarters, but it's lessening quarter after quarter as it starts to normalize. So not giving any specific guidance other than I do expect it to remain elevated as we exit the year but not to the degree that we previously thought. We were thinking it was going to be 2x previous kind of historical levels. We now think it will be less than that but still be above historical levels.

Operator

The next question is coming from George Notter from Jefferies.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

I guess, I wanted to dig in on gross margin a bit more. Could you walk us through some of the puts and takes on gross margin? I guess, I'm thinking more about some of the impacts on the supply chain crunch. It sounds like -- I imagine there's certainly high-cost componentry that's running through the gross margin line right now. Also, it sounds like there's some breakdown associated with excess and obsolete inventory here as well. I guess, can you give us a sense for how big those components are in terms of their impact on gross margin?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. So I mean we are seeing -- we're definitely seeing some improvements in what we used to refer to as the transitory costs, right? These were predominantly logistics costs and expedite fees or purchase price variance fees, where we're paying more just to get a hold of the product that was scarce, hard to get. We clearly are not paying any more of those fees as we are able to get products pretty much on time with standard lead times at this point. The supply chain has completely normalized from a lead time perspective.

But we do still have some inventory that we bought at prior higher prices, as you mentioned, and that's going to bleed through over the next few quarters. But each quarter, we're getting more and more of that benefit or less and less of those additional fees on the expedite side.

Logistics has effectively recovered completely, right, where the logistics cost that we were paying -- the elevated logistics costs have completely normalized. And that's obviously benefiting our current gross margin results and our expectations going forward.

The one area that has gone negative, if you will, or have gotten worse over the last 12 months are those inventory carrying fees that I mentioned. And that's really just a factor of the balance sheet and inventory that we're carrying. So I would expect those costs to remain for the next few quarters higher-than-normal levels as inventory remains higher-than-normal levels, but I do see a path to recovery on those as well. All this is factored into our guidance, obviously, for Q4 as well as our expectation that next year, we expect to grow gross margin.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

Got it. Okay. That helps. And then also back to the Services gross margin strength this quarter, I guess, I'm just curious for more detail on what drove that strength. It sounds like it was probably the SaaS business. But that Services gross margin really did step function up in Q3. I guess I'm wondering exactly if that was the driver or there's other things at work there.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. The revenue -- SaaS was definitely a part of it and has been a continual part of it for the last few years as SaaS is becoming a bigger part of our overall business. We disclosed on the call, our ARR business at $357 million at an all-time high and growing quite nicely. So that is becoming a bigger factor of overall services.

However, I don't want to discount the Maintenance business, which also grew nicely in the quarter and the efficiencies we're getting within our services organization. So really, this is a situation of revenue growth and cost of revenue decline, and that's resulting in the margin expansion that you're seeing.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

Got it. Just one last one. Is it fair to say there's no onetime items driving that gross margin this quarter that's really the baseline that you should continue to kind of move off of going forward? Is that fair to say?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

I think it's fair to say that directionally, we should be moving up as we move forward. Any given quarter, you might see some small anomalies, but I do feel good about the ability to continue to grow gross margin in a more of an aggregate time period basis.

Operator

The next question is coming from James Fish from Piper Sandler.

James Edward Fish - *Piper Sandler & Co., Research Division - Director & Senior Research Analyst*

Kind of working back on Simon's question before on Mist. It's been a huge behemoth. We constantly hear the need to upgrade wireless LAN due to specifically going back to work, actually, and all of us having Zoom and Teams meetings still actually in the office with those that are not in the office. Those apps obviously are showing bandwidth improvements. And we've been seeing the strength in wireless LAN for a while now.

And really the core of this, Rami, is how much more is left in this business from a -- let's separate the market perspective, as Simon pointed out, like the decline potentially for next year versus the outright share gains. What do you see left in the pipeline and opportunity?

And Ken, just for you, I mean, just round out this discussion, prior to the supply chain glut and as you guys matured, it looked like you averaged about 12% to 14% declines in Q1. And Q1s have been about 22% to 23% of your year. That kind of backs me into about a 2% decline for next year. And I know you're not going to let that number necessarily, but you're talking about orders growing, as you said. So I guess, what kind of order magnitude are you looking for, for growth? And are you thinking of it as low single-digit decline for next year is the way we should be modeling?

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Okay. Let me start with your first question. And Ken, I'll let you talk a little bit more about the commentary for next year. So I'll address the Mist question from both the standpoint of market dynamics and then what's happening with our business more specifically.

From a market dynamic standpoint, I think it's really important to understand that the -- if you look at the campus and branch market all up, that's sort of a slow, maybe flattish-type market opportunity. Within the campus and branch market, there's actually a segment really Cloud-managed. These are basically enterprise solutions where the control and the management of that solution is really done through the Cloud. And that part of the market is actually growing at a healthy clip, and I expect that it will continue to grow through next year as well. And that is the opportunity that we are entirely focused on, at least when it comes to campus and branch.

Now every single one of our access point is connected to the cloud, managed through the cloud with an AIOps engine Marvis in the cloud. And all of the growth that we're seeing now in the wired switching as well as in the WAN is happening through the cloud. And even the security capabilities, such as network access control that we've introduced, is a cloud-based solution as well.

So I think it's a little bit -- it's wrong to look at the growth of just the campus and branch market all up. It's actually more useful to look at it from the standpoint of that cloud-connected portion of the market that's actually growing at a much faster clip.

Then in terms of the solution itself, really, when it comes to harnessing the power of AIOps, and I know it's a bit of a used and abused words out there. I mean the proof is in the pudding. Our customers today are seeing real benefits. Reduction in number of tickets by 90-plus percent; reduction in total -- the time frame it takes to deploy a new solution from what used to be a year to a matter of weeks, if not maybe a month or so. The root cause analysis that used to take days with all of the frustration. People are trying to use the network to do whatever they want to do has been reduced to essentially no time at all because most of the time, we're proactively identifying issues and fixing them.

You mentioned Zoom. We have already integrated Zoom visibility into our Mist solutions so that when there is, in fact, some sort of a video issue, we can, if not proactively, instantly provide the IT staff visibility into whether the issue is more in the application side, the wireless side, the wired side, the cloud, et cetera. And that's the capability that our IT customers are really, really happy to see.

So I know I'm maybe beating a little bit of a dead horse here. I'm very optimistic about the competitiveness of our solution in the market, whether it be a challenged market or not.

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

And when it comes to 2024 revenue growth, it's a little too early to provide guidance for 2024, particularly with some of the weakness we're seeing with the Cloud and Service Provider customers. But let me walk you through some of the puts and takes.

I mean, clearly, the backlog drawdown that we're going through in 2023 is going to provide a pretty significant headwind to revenue in 2024. Orders are going to need to accelerate just to offset some of that backlog-related headwind that we're experiencing from a revenue perspective in 2023.

With that said, I do expect orders to accelerate in 2024. I expect full year growth across all of our verticals. I also expect Enterprise revenue to grow in 2024 on a full year basis. So really it comes down to Cloud and SP and the timing and pace of that recovery. And that's a little bit too early to call at this point. So we're not giving specific guidance on 2024 other than based on the backlog expectations and our order expectations in Q1, we do expect to see a return to more traditional patterns.

Operator

The next question is coming from Karl Ackerman from BNP Paribas.

Karl Ackerman - *BNP Paribas Exane, Research Division - Research Analyst*

I have 2 questions. Rami, perhaps a question for you to start. So the upside in the quarter appears to be on the Services side, while product growth is going the other way. I understand there is a mix dynamic at play on services give the growth that the company is seeing in Enterprise. But where do you think we are in the cycle for Service Provider and Cloud spending on product hardware?

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Yes. So Cloud and SP, as I mentioned, they're definitely going through a period of digestion after they -- for the last couple of years, have bought a lot of equipment. I mean, if you recall, in the Cloud Provider segment for us or a vertical for us, there were a few quarters where their order growth was in the 100% year-over-year sort of range. So the fact that they're going to take some time to go and to consume that inventory to deploy it is as expected. And this is also happening within the SP space as well.

The other thing that I can say is, if you look at these businesses over the years, there have been ebbs and flows. They have always been lumpy. And I do not believe that there's anything structural that is happening right now in either the SP space or the Cloud space that would suggest that this is the new normal. I expect that they will both bounce back. And as Ken mentioned, orders in both of these verticals will recover next year.

In terms of the timing, the time frame, it's difficult to say. All I can tell you at this point is that it's going to take a few more quarters of digestion before we start to see a meaningful recovery, meaningful rebound, but I'm optimistic it's going to come.

And maybe the last thing I would say is the following. It's the very fact that these verticals, Cloud and Service Providers, have traditionally been lumpy that we, several years ago, decided very strategically, very deliberately to pursue the Enterprise and to diversify our business into the Enterprise. And it is, in fact, now the Enterprise, which, for the first time in our history, represents over 50% of our revenue this past quarter is giving us the resilience that we need to weather challenges in SP and Cloud.

Those challenges are going to go away. It's not going to be the new normal, as I mentioned. And eventually, we'll have the benefit of a rebounding SP and Cloud business in addition to an Enterprise business that I believe will continue to perform well without all of the typical gyrations of the business that we have endured in SP and Cloud historically.

Operator

And the next question is coming from Atif Malik from Citi.

Atif Malik - *Citigroup Inc., Research Division - Director and Semiconductor Capital Equipment & Specialty Semiconductor Analyst*

I have 2. The first one is for Rami. Rami in your prepared remarks, you sounded quite constructive on the Ethernet adoption for AI clusters. You talked about front-end, back-end, inference, storage. Can you talk about the timing of the Ethernet adoption? Is this something like 2025 event? Or are you seeing real pilot or volume rollout?

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Yes. So I'm actually quite bullish about the AI cluster opportunity. As I mentioned in the last call, I think we all have to acknowledge that today, the technology of choice for connectivity between GPUs in either inference or learning clusters is InfiniBand. It's not Ethernet. However, the momentum behind Ethernet in the industry is very strong. And so I believe it is a matter of time before Ethernet reigns as the [fabric] technology of choice in AI clusters. And I do believe this will present opportunities for us.

In terms of timing, I think next year, 2024, maybe closer to the second half of the year and in particular, what we're seeing, especially among the Cloud Majors customers for us, there are a lot of projects. There are a lot of opportunities out there where we are being asked. There have been some good technical dialogues about how we move Ethernet to become sort of that cluster technology of choice for either learning or inference for their solutions.

And in fact, even large enterprises, we're seeing that more and more large enterprises, financial services, insurance companies, even health care, they're pursuing these private clusters. All up, I'm optimistic about the opportunity. I like how we stack up from a technology standpoint with the combination of our customer and merchant silicon; our Junos operating system feature that we developed specifically for the Ethernet cluster solution; and Apstra, which provides the automation and the visibility into it's Ethernet AI cluster solution, that gives me good optimism for capturing our fair share, if not more, in this market opportunity.

Atif Malik - *Citigroup Inc., Research Division - Director and Semiconductor Capital Equipment & Specialty Semiconductor Analyst*

Great. And then, Ken, when you guys talk about your Enterprise revenues to grow next year, is that growth mostly attributable to the market share? Or are you seeing the overall market also grow for Enterprise?

Kenneth Bradley Miller - *Juniper Networks, Inc. - Executive VP & CFO*

Yes. So I expect our Enterprise revenue -- I expect our Enterprise business to grow faster than market. So I do think we will take market share. The market, as many are predicting, is expected to slow down pretty significantly next year as compared to this year, but we expect to be able to grow -- even if the market is slightly down, we would expect to grow our Enterprise business. So we are absolutely expecting market share ticking.

Operator

The next question is coming from Meta Marshall from Morgan Stanley.

Meta A. Marshall - *Morgan Stanley, Research Division - VP*

Maybe first question, I know on the Enterprise side, you guys are not as tied to macro just given kind of the share gain position you're in. But just wanted to get a sense of any commentary around time from initial WiFi sales to kind of the upsell of additional campus switching or additional SD-WAN, just whether you're seeing an elongation of that in a more challenged macro or if it's actually shorter just given the compelling ROI.

And then maybe just as a second question, just the visibility. As we've kind of extended this inventory digestion period on Cloud and Service Provider, just the visibility that you have within those customers of just how much inventory they have. What is kind of the ongoing dialogue to get a sense of just when you guys could have a little bit more sense of visibility there?

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Thanks for the questions, Meta. So let me start with the first one on macro, and I think specifically the timing between sort of initial sale of a Mist solution to subsequent use cases. It honestly is all over the map. We have seen accounts that have traditionally been WiFi customers have loved the technology, the ease of operations and years later, have come back to us saying, hey, we'd like to introduce wired, WAN, et cetera.

But in many cases, we're actually selling the full technology stack day 1. In fact, we are deliberately tracking sales of full-stack solutions, and we hit a record -- another record in Q3, where a full-stack solution would be some combination of use cases; wired and wireless, wired and WAN, wireless and WAN, et cetera. And we're continuously adding more and more of these capabilities, an example of which would be the NAC, network access control, where in the Q3 time frame alone, we added around 15 new customers and it's starting to grow quite rapidly. We're incenting our sellers to cross-sell. We're enabling them to cross-sell. It's definitely part of our sales motion.

On the visibility, I guess, it really goes back to the question I just answered recently. It's difficult to know exactly how much inventory levels our customers have, but we do know that, at least for the next few quarters in both SP and Cloud, their focus is going to be on deploying what they have bought -- first receiving what they have bought, deploying it, getting it up and running before they start to feel the need to make meaningful orders again. It's just going to be measured in a few quarters.

Operator

And the next question is coming from Tal Liani from Bank of America.

Tal Liani - *BofA Securities, Research Division - MD, Head of Technology Supersector & Senior Analyst*

Two questions. Number one is the Cloud decline -- Cloud vertical declined 28% this year -- this quarter. Can you tell us what's the basis for the decline? Is it the absorption of historical orders? Or is it delays of projects? Or what's kind of the basis? That's number one.

And number two, the Enterprise vertical, this is the fourth quarter of very, very strong growth, 37%. And if I look back, it's 4 quarters that you doubled the growth from the previous 4 quarters. And the question is the same, more or less, here. What is driving it? And then once we get to next quarter and the following 4 quarters, the comps are very tough. What do you think is going to happen to the growth rate? And again, I'm asking qualitatively just to understand what's driving it.

Rami Rahim - *Juniper Networks, Inc. - CEO & Director*

Okay. Thanks for the questions, Tal. Let's start with Cloud Providers. The biggest thing driving the decline today is the fact that lead times have gone from what was over a year to normal, just a few weeks. And so the need for them to purchase in sort of like way upfront from when their needs are is just not there anymore. And therefore, they've just reduced the orders that they're placing. So that is the #1 thing that's affecting our business. It's not the only thing.

There are definitely -- there have definitely been some project pushouts. I think macro has affected their own businesses and the need for equipment. So that would be the second thing. And I think the other thing is they have shifted some of their priorities to, for example, AI, GPUs, which, as you know, are extremely expensive. So those are the main reasons.

I again feel the need to reiterate: I'm optimistic long term. I do believe that nothing has changed structurally, and I believe that I would not bet against the businesses of Cloud Providers. And therefore, it remains an incredibly important and strategic part of our business. It's just going to be a matter of time before we start to see the rebound in the recovery there.

In Enterprise, yes, we have seen and I believe we'll continue to see strength. I've talked at length about Mist. So I'd be remiss not to mention also what's happening in our data center business. We had record Apstra revenue. Each Apstra sale, which is our automation solution for the data center, intent-based automation solution, is pulling meaningful hardware at this point in time. Apstra new logos have grown by 80% on a year-over-year basis, and the pipeline remains incredibly solid.

Next year, the compares become more difficult in the Enterprise, no doubt. And this backlog draw in 2023 that Ken and I have both mentioned does affect Enterprise as well. It's just that in the Enterprise space, orders continue to be very robust, and we expect order growth next year. So the path to revenue growth next year is much clearer. But obviously, yes, it becomes more difficult from a year-over-year standpoint. So you should just factor that into your model.

Operator

Thank you. That was all the questions we had today, and that does conclude today's conference. You may disconnect your lines at this time, and have a wonderful day. Thank you for your participation.
