

04-Dec-2013

Juniper Networks, Inc. (JNPR)

Credit Suisse Technology Conference

CORPORATE PARTICIPANTS

Kathleen Nemeth

Vice President-Investor Relations, Juniper Networks, Inc.

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

OTHER PARTICIPANTS

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

MANAGEMENT DISCUSSION SECTION

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay. Good afternoon. We'll get started. I'm very pleased to have from Juniper, Robyn Denholm and Kathleen from IR and I think they will open with perhaps some forward-looking statements and then we will go into some Q&A and some presentation.

Kathleen Nemeth

Vice President-Investor Relations, Juniper Networks, Inc.

Thank you, Kulbinder. And good afternoon and welcome everyone. And welcome to those of you who are joining us on today's webcast. We're delighted to be here. I do want to point out that during our discussion today whether in the presentation that Robyn walks through or through the discussion that we have with Kulbinder, we may make forward-looking statements. There are risks and uncertainties associated with those statements. For a full list please see our most recent 10-Q filed with the SEC.

With that, I'll turn it over to Robyn.

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Thanks, Kathleen. So, I was going to go through a few things this morning. Firstly, I just – or this afternoon actually, I was just going to go through the strategy overview. Many of you've seen this before, but basically, as a company what we are focused on is using the technology from our routing, switching and security businesses into both the service provider and the enterprise markets.

In the enterprise markets, we go after the customers in those markets that most resemble the ones that are in our service provider market. We're also in seven domains of the network, which are listed here: Access & Aggregation, Core, Edge and also the Data Center as well as the WAN and the Campus & Branch and also on the Security side in the consumer and embedded area.

In terms of how the business is evolving in terms of SDN [Software-Defined Network] and NSV [Network Service Virtualization], we put this slide together to sort of help people understand what is going on from our perspective. So, if you look at the different layers of the network, there are certain layers within the network that are actually focused more around the scale, performance and reliability of the network. So, making sure that packets in the network aren't dropped on the floor or actually make it to their destination, et cetera, and also coping with the throughput and volume of traffic that's happening.

And then there is areas in the network that are actually more about virtualization and scalability, but also the agility and time to market of services. And the way we look at our businesses between software system and silicon and our core technologies in those areas, that's how we look at the market evolving over time from both an SDN and an NSV perspective.

So, if you look at routing and switching, those, in terms of the way we look at it, really help with the scale, performance and reliability, and security is the type of application as well as things like load balancing, et cetera, that reside in the top part.

So, in terms of results, we've had five quarters of year-over-year growth and that growth is accelerating in terms of our performance year-to-date. If you look at our year-to-date performance from an earnings perspective, we are up over 50% in terms of expansion in our earnings. We also have had very good demand metrics. For the third quarter, our book-to-bill was greater than 1, and our backlog is at healthy levels as well as our deferred revenue growing quarter-over-quarter.

In terms of uses of cash and sources of cash, I've put this chart together to help explain how we are viewing our capital allocation policies. So, if you look from the beginning of 2008 through to the end of last quarter, we have actually generated about \$4.6 billion of cash. Obviously, some of that is onshore and offshore, uses of cash, we've actually had capital purchases of about \$1.3 billion over that period of time and \$600 million worth of M&A from a cash perspective, obviously there is some equity involved in those M&A transactions. And then, we've repurchased about \$1.9 billion worth of shares. We've brought the share count down over that period of time, as we've also continued to use stock from an incentive program perspective with our employees, and as I said, also used some stock to deliver on our M&A.

Of our \$4 billion of cash that's on our balance sheet at the end of the quarter, 40% is onshore, which is about \$1.6 billion and 60% is actually offshore. And so, I wanted to just summarize from a strategy position. Our strategy is very focused around growing our revenue. Our differentiation is in software systems and in silicon from a company perspective. We continue to focus on driving earnings growth through not only revenue growth but also a prudent management of our OpEx as we move forward.

And then we do generate cash wealth as a business, and we are very thoughtful in our capital allocation approach. So with that...

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Great, thank you for that info, Robyn. And maybe if I kick it off with some Q&A. You mentioned that in your initial comments as well that it sounds like visibility is improving, can you speak about, maybe summarize the conversations you're having with your customers as you've gone into the back half of this year, how they sound about going into 2014? You can either talk about from a geographic perspective or service provider versus enterprise, whatever makes most sense?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah, I mean in terms of the business, we have seen five quarters of year-over-year growth sequentially. So if you look at our service provider business, we actually started to see that first in North America about a year ago. And so what we've seen is an increase in spending and also design wins and improvements from a routing perspective, in the carriers first and then in cable and then in content. And so, those three verticals within the U.S. are doing quite well and we continue to see that through the first half of at least of next year, in terms of growth rates.

If you look geographically, EMEA, we started to see improvements in terms of year-over-year growth rates and sequential growth rates. We started to talk about that two quarters ago and we actually saw revenue uptick last quarter and the third quarter. And so, that's a result, again, of design wins that have either started to deploy or yet to be deployed in EMEA service providers.

And then in Asia Pacific, we actually saw an uptick in business in the third quarter in terms of Asia Pacific. We announced some design wins and actually some revenue wins in the third quarter in China. We also saw some in Australia and Japan and so we're seeing some good wins there.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Great, thank you for that. Is the – can you speak about, with respect to Asia Pacific there's been commentary from various peers of late that there's been mixed, I guess, emerging markets trends or even specifically in China. You haven't seen that or do you think you're gaining share or you're executing differently, what would you think is going on for Juniper versus the market?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah. So specific to China, we have a very different strategy in China compared to our competitors. We did a strategic review about five years ago where what we've done in China is actually be very focused on those areas where we have the most differentiation from a product perspective. And so, we have won business in China and we've won business even in the last quarter. In terms of the political landscape there, obviously we're too small to be in the fray, if you like, and I'd like to keep it that way, actually. So, from my perspective, our business is good. It's always been lumpy given the strategy focus that we have, but we're pleased with the team there and the way that they've been executing.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

And on specifically on the routing business, Juniper has spoken about, I think, over the last few quarters about just core networks running hotter, being very high levels of utilization, where are we in that dynamic now and how does that impact visibility as we head into next year?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yes. If you look at routing in particular, across the board whether it's in edge or in core we have the best lineup of any competitor that's out there. We believe in the products that we have in market, we also believe in the roadmaps that we have for our routing products.

If you look at the edge the edge has been driving a lot of revenue growth on a year-to-date basis, but in the third quarter we actually did see our best core routing quarter for several quarters. And we put that down to the fact that traffic continues to increase. We do need to see that traffic actually be handled by increased capacity. And given the fact that our technology has been out there for several quarters and has been tested and certified for the networks, we're starting to see that upgrade cycle as well as insertion with PTX both in terms of our install base and our competitors install base as well.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

And is that core routing you're beginning to see, whether it's traffic growth or – is that mainly a U.S. phenomenon or is it...?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

No, we're actually seeing it in networks across the world.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay, okay. Maybe on the competitive front, can you speak about how that is changing as we go through this year on the routing side. You've obviously had a lot of pressures and competitive pressures just in the edge, full stop. On the core side as well, we're now seeing some new entrants of late or new product come into that market as well. How do you see that dynamic playing out and how does that make you think about the pricing environment?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah. I think in terms of routing, I'll go back to what I said at the beginning. We believe that we have the strongest product lineup, whether it's in the core or the edge, of any competitor out there, and we're not standing still. We continue to develop new features, functionality. We have a very rich roadmap as we move forward. And we believe, given our year-over-year double-digit growth rate in the U.S. as well as growing the edge routing lineup all told globally double digits that we're taking share in the routing landscape. And so, our view is that that's not only a testament to increased spending but also the competitiveness and the fact that our products have been out there for the time they have to actually be certified and qualified for networks.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

And, okay, okay. If we move on to the area of SDN, can you speak about where you are in the process of introducing your SDN products and your strategy. I think you recently spoke about a number of trials going on as well? And then as we look out over 12 months, 24 months, 36 months, how do you think it will be deployed with which customers and which kind of features first and foremost?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah. I think obviously SDN is a very heavily used three-letter acronym. In terms of the marketplace, an NSV is probably equally as used. In terms of products and deployments that we have going on right now, we are shipping

the Contrail controller. We are also – we've just talked about our data center offerings under the brand name of MetaFabric in terms of the evolution of data center and how that fits in with our SDN vision.

If you sit back strategically, what we were doing with QFabric even five years ago, very much is along the same principles as SDN. Now clearly SDN has some open protocols, the new products that we've brought out are very compatible with those open protocols. And we are in 40 betas around the world with our Contrail controller. We also have the most programmable switches in the market today in terms of the data center. And we're seeing good customer receptivity to that.

I think one of the key things with SDN as it is with any architectural shifts that happen, at least in the network, is that customers want to know what to do and how to actually deploy and what applications first and how to do that. We have come out with a very easy four-step process for customers to actually think through what they do today and what they do overtime. And that's one and given the fact that we have shipping product and we have software that does run on our systems, that we're able to help them think through that journey as well.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

As you think about SDN adoption into your customer base, with these 40 initial customers going from beta to deployments I guess, how should we think about the impact on your margin structure? Because I guess on the one side, you become more open and it starts working with other competitors' hardware, you could argue, it opens up an addressable market, but on the other hand you could also argue that it might lead to a lot more fragmentation, maybe a little more competition, maybe commoditization as well. So what comfort can you give to investors that – and it could whatever time horizon you want to talk about, this isn't a gross margin dilutive move or it's just necessary and that in the end, the gross margin, I guess, for the networking market may come down overtime as a result of SDN, because I think that's the real fear that's out there.

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah, no, and I understand that fear. I think if you look at, over time, there is obviously a profit pool that's associated with networking overall. There are different parts of that market. We have very little share today in the data centers around the world, and if you – we're at less than 2% or around 2% in terms of the overall switching market. The way that we look at it is it serves our interest and our shareholders' interest to disrupt that market to actually drive increased profits over time through an asset that helps our customers actually through this SDN journey or getting more programmability or functionality or more manageability and being able to manage their networks through automation than it does doing it manually.

So our view is that from an overall business model perspective, I'm sure it will change over time, but our view is that we need to – we've opened the Contrail controller up to the open source community so that we actually get more developers in that space, writing applications that help on the services layer, that's a very important strategic move in order for us to be able to create momentum and behind the movement, if you like, around SDN. Because until there are applications that will run on different systems, then SDN will only be on paper, it won't be a reality, right?

Even things like in our software businesses inside of Juniper, we have created a licensing scheme called JSA, Juniper Software Advantage. And what that enables you to do is take the software that we have today that may run on a dedicated appliance and actually move that to a cloud environment if that's how you deploy it as a customer. And so that is getting ready for that wave of applications that may not be – have to sit on a separate appliance in the network.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

So, if I understand that, as I summarize that point, is it more the argument that you could go out there, hopefully disrupt the data center where you have relatively low exposure to, that's an incremental revenue and gross profit dollar opportunity versus, let's say, in your more traditional routing products as those get opened up to SDN environments or network switch virtualization, that even if that commoditizes, in net, this is going to be an accretive? Is that the right way of thinking about it or do you think even in the traditional telco markets where you tend to have a stronger position, you can hold your current level of profitability?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah. I think it's more the former with the one exception. We don't believe that over time, you can do high performance networking in a commoditized way. Maybe in the fullness of time, the merchant silicon and that type of thing will be as good as what you can do with specifically designed silicon. That's why our view is you have to have all three elements to actually create an SDN world or an NSV world. You have to have systems and silicon as well as software and we believe that as a company we have great assets in all three, in order to be able to make the vision of SDN come to life.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay.

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

And the proof point to me is that before the industry took hold, in terms of the acronym, that's what we were working on with QFabric. If you look at the architecture of QFabric, and you look at the SDN architecture, it's very similar. The difference is that there are now open standards where there weren't open standards six years ago.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay. And maybe moving on to the financial model, can we speak a little bit about the cost structure of Juniper, and the scope for it to become, let's say, more efficient? Because compared to many of the larger IT, telecom equipment, networking stocks only that we cover, the operative sales ratio is still very high, in fact in the low -40s. It's almost one of the highest, I think, of all the companies that we looked at, and from where we are now, can you speak about what the approach is to that cost structure? Is it a case of direct cost cutting, is it case of revenue leverage over the next 12 months, a balance of the two, and what efficiency do you think are still the low hanging fruit for the company versus something a bit more direct that needs to happen?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah, so I think, firstly, there is more opportunity. So as we look at it as a company, we've taken a measured approach to taking costs out. So this year 2013, we will be down in terms of OpEx year-over-year, in an environment, where we have actually been growing revenue. So, that's the first thing. The second thing is, there is more opportunity to get more efficient and effective, and we have been doing that progressively.

So even in the fourth quarter, we actually shutdown a project called Mobile Next, it was a product line. And so, what we've done with that is, we've taken out some head count and that type of thing. And that aligns with the strategy because, as we were talking before, we do believe that software won't necessarily need to have some dedicated devices. And so even in the mobile evolved packet core, we think that can be run as a service on top of routers. And so shutting that project down was one of the efficiency areas or focused areas, if you like, in terms of aligning with the strategy. And then continually looking at ways of doing things more effectively and efficient is something that we've been doing.

Over the course of 2013, we've taken some pretty aggressive moves on the supply chain and actually moved from three major contract manufacturers to two. That happened at the end of the second quarter. And so as we move forward, we'll continue to get more scale and efficiency from that move as well as many others that are ongoing at the company.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

And with the, I guess, so going back to the example, I guess, of Mobile Next, on the product portfolio side, is there an argument that Juniper should be somewhat more focused or would you say that everything from enterprise to security to wireless LAN products to the routing is core? But would you say all of those – you would go as far as looking – evaluating some of the product lines within those segments as well or...?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

So we continually evaluate different product lines and the effectiveness of those product lines in terms of both from a strategic perspective as well as from a market and market share perspective. So that's an ongoing process within the company. Having said that, we also sense that there are areas where we just get more efficient in terms of how we do things and that's another focus. So to me, to answer the big question, we do expect to continue to drive leverage in the model both through revenue growth and also through getting more efficient in reducing costs over time.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay, great. Maybe one final question from me then we'll open up to the audience if there are any. With respect to uses of cash, is there an argument to maybe giving a committed level of cash return to shareholders out of free cash flow given the healthy cash balance you have? Given the – it feels like cash flow as a trend should be rising going forward or do you still need to retain flexibility for M&A or how should we think about usage going forward? Is it the same model that you've seen historically or can you commit to something in terms of how much you would deploy back?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah, I think if you look historically, we have actually returned more than our free cash flow that we've generated over the last five years, back to shareholders through our buyback program. And you can argue at the effectiveness of the buyback program at least in the initial period of time. We have in recent quarters actually brought down the share count relatively significantly. On the chart that I showed we're about 20 million shares down compared to the beginning of 2008, and most of that has happened over the last six quarters. So both through reduction in the

issuance of shares as a percentage of the total, as well as a relatively aggressive buyback program, we've actually, I think, been more effective with that buyback over the last six quarters.

In the near-term, I expect that to continue. In the long-term, obviously, as I talked about before, we'll review that strategy just as we are with other parts of the strategy in the company as well.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay. Are there are any questions from the audience? Okay. Maybe one final one from me then. On the security business, we've seen the stabilization of that of late. Can you speak about what's been driving that and are we at the point of that turning the corner now?

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Yeah. I wouldn't – we are approaching stabilization. Until we get to flat to improving year-over-year, I won't call it stable. But we did see an increase sequentially in revenue in the third quarter, which is an encouraging sign, and where we saw that come from was where we thought it would come from first, which is on the service provider side, which is a business that we've built with this new generation of security products. So, that actually had an uptick in revenue as well as the data center where we have the most differentiation from the security offering. On the campus and branch side, we did see some sequential improvement, but the majority of it came from here, which is where we thought we would have the first turnaround happen. So, our view is that through the end of this year, we get to reducing the decline year-over-year and then, next year, we should grow the business.

Kulbinder S. Garcha

Analyst, Credit Suisse Securities (USA) LLC (Broker)

Okay, great. With that, I think we're just out of time. Thank you very much.

Robyn M. Denholm

Chief Financial Officer & Executive Vice President, Juniper Networks, Inc.

Thank you. Thanks very much.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2013 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.