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JNPR - Q4 2017 Juniper Networks Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Juniper Networks Fourth Quarter Fiscal Year 2017 Earnings Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I'd now like to turn the conference over to your host, Jess Lubert. Thank you. You may begin.

Jess Lubert

Thank you, operator. Good afternoon, and welcome to our fourth quarter 2017 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 that are subject to risks and uncertainties. Actual results may differ materially as a result of various risk factors including those described in our most recent 10-Q and 10-K, the press release and CFO commentary furnished with our 8-K filed today and in other documents that we file with the SEC from time to time. All statements made during this call are made only as of today. Juniper undertakes no obligation to update any forward-looking statements.



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Our discussion today will include non-GAAP financial results. Reconciliation information can be found in the Investor Relations section of our website under Financial Reports. Revenue guidance is provided using ASC 605. We will adopt ASC 606 for Q1 2018 and intend to provide a ASC 606 to 605 reconciliation when we report first quarter results. Commentary on why we consider non-GAAP information a useful view of the company's financial results is included in the press release furnished with our 8-K filed with the SEC today.

(Operator Instructions) With that, I will now hand the call over to Rami.

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

Thank you, Jess. Good afternoon, everyone. We reported mixed results for the fourth quarter. While revenue and non-GAAP EPS were both above the midpoint of guidance, gross margin remained under pressure, and we continue to experience weakness in both Routing and in the Cloud. This weakness is primarily being driven by the shift to a scale out from scale up architecture, most notably at several of our largest Cloud customers, which appears likely to persist through at least the upcoming quarter. This shift is impacting our financial results by creating near-term revenue headwind as new architectures take time to roll out and ramp and margin pressures as we look to disrupt our own business with new lean core technologies that deliver both material efficiencies for our customers and price performance advantages versus competitive platforms.

Despite this ongoing headwind in a small number of hyperscalers, we remain confident in our position within the Cloud vertical, where we have built substantial footprint with many large cloud providers over the past few years. This has been the result of our innovative products and also our close support of our Cloud customers as they've grown. As their growth continues, we believe it is clear that their network architecture needs to evolve, and we are leading the charge to more automated, cost-efficient, scalable networks.

What's important is that we're confident in our belief that we continue to maintain our strong footprint as these shifts unfold and seeing solid demand for PTX ports, which have already surpassed MX port shipments within the Cloud vertical. We continue to challenge the status quo. And while that, at times, results in short-term disruption similar to what we're currently seeing, we believe this approach will make us more relevant with our most important customers. With network traffic at our Cloud customers seeing rapid growth and many of these customers having already made significant progress in their architectural transition, we believe the headwinds impacting our Q1 outlook are likely to prove transitory and expect to see sequential growth through the remainder of the year with a return to year-over-year growth likely by the end of the year. We believe our optimism is supported by our deal pipeline, the opportunity our customers see with our new product innovation and the momentum we are seeing with new accounts across various customer verticals.

While much of my commentary has focused on the Cloud vertical, it's important to highlight that we continued to gain relevance with our Tier 1 telco and cable customers and build momentum with Strategic Enterprise accounts, where we added nearly 3,500 new logos in 2017. Both of these remain important verticals that give me confidence in the long-term opportunity and trajectory of the business.

Now I'd like to summarize the performance across Routing, Switching and Security in Q4. In Routing, our business declined sequentially and year-over-year. While this weakness was seen across product lines due in large part to continued deployment delays at our largest Cloud customers, new PTX footprint opportunities within the Cloud and continued MX demand in Telecom/Cable verticals, where service creation remains mission-critical, continue to give us confidence in the longer-term trajectory of our Routing portfolio.

In Switching, we saw double-digit sequential growth in Q4, even though the business declined year-over-year. Normalized for lumpiness from our large hyperscale customers, our QFX product line continued to grow at double-digit rates year-over-year. That growth is happening across public and private cloud segments, driven in part by 100-gig adoption. In addition, our innovative pipeline remains strong as evidenced by advancements in automation and telemetry, our leadership in network protocols like EVPN as well as our Fusion fabric solution that simplifies data center operations. We remain confident in the competitiveness of our QFX product line across all verticals including cloud and hyperscalers.

In Security, our business saw both sequential and year-over-year growth driven by momentum in financial services, government and telco sales. More customers are recognizing the value of leveraging the entire network for detection and enforcement against cyber threats. We believe our software-defined secured network solution is gaining traction, and we've added many new customers in Q4 that are leveraging its benefits. Our



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improvements in security was broad-based across products and geographies, and we continue to see an uptick in million-dollar-plus deals, which is providing confidence our Security business is likely to see a return to growth in 2018.

In the quarter, we continued to see momentum with Contrail and had several new customer wins, including Tier 1 carriers in both Europe and Asia, as well as recurring revenues from the renewal of existing annual subscriptions. We are executing on an extremely compelling product road map for Contrail that we expect will result in an expansion of its use cases across a broader set of customers. We are also seeing success with our SD-WAN solution, which has already secured 3 Tier 1 service provider wins, while the AppFormix customer base has steadily expanded across SaaS, enterprise and telecom operators. AppFormix and Contrail have been integrated for seamless operations management and advanced analytics of Juniper's hardware and software products in several customer use cases.

In Services, we saw strong renewal and attach rates of support contracts, resulting in another quarter of year-over-year growth. We remain committed to all of our strategic verticals, especially the Cloud, and believe that we are more relevant than ever to our customers and the industry. We're innovating in ways that truly matter to all network builders and operators that are embracing cloud architectures to drive greater levels of operating efficiency and service agility. I'm very excited about the opportunity we have in front of us.

In summary, while we're not satisfied with our second half 2017 results or our outlook for Q1 2018, we're confident that we have the right strategy and solution portfolio needed to win in the market and drive a return to growth by the end of 2018. Based on this confidence, we have announced a new \$2 billion buyback authorization, with the intention of initiating a \$750 million ASR and an increase in our quarterly dividend by 80% to \$0.18 a share. I would like to extend my thanks to our customers, partners and shareholders for their continued support and confidence in Juniper. I especially want to thank our employees for their hard work and dedication, which is essential to creating value for all of our stakeholders.

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

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

Thank you, Rami, and good afternoon, everyone. I'd like to start by discussing our fourth quarter performance and results. Our fourth quarter revenue and non-GAAP EPS results were slightly above the midpoint of our guidance. Total fourth quarter revenue was \$1,239,000,000, down 11% year-over-year, and non-GAAP EPS was \$0.53.

We continue to see architectural shifts in the Cloud vertical impact our Routing and Switching businesses, which both declined year-over-year. However, Security was up both sequentially and year-over-year. Our Services business continued to be solid, posting year-over-year and sequential growth, driven by strong renewal and attach rates. In reviewing our top 10 customers for the quarter, 5 were Cloud, 4 were Telecom / Cable and 1 was Strategic Enterprise. Of these customers, 2 were located outside of the United States.

Product deferred revenue was \$334 million, up \$11 million or 3% both year-over-year and sequentially. Product gross margins were below our expectations, primarily due to product mix as we have less Routing revenue as a percentage of total revenue for the quarter. Non-GAAP operating expenses declined 6% year-over-year and 1% sequentially, reflecting lower variable compensation as well as our continued focus on managing expenses. As a percentage of revenue, fourth quarter non-GAAP operating expenses were 38.6%. In the quarter, we had good cash flow from operations of \$214 million. We repurchased \$330 million worth of shares and paid \$37 million in dividends.

Moving on to the results for the full year. Fiscal 2017 saw modest revenue and non-GAAP EPS growth of 1%. Routing declined 7% due to ongoing architectural transitions in the Cloud vertical. Our Switching business had a record year, up 12%, driven by QFX, which grew 25%. While Security declined 8% for the year, we did see sequential growth for the last 3 quarters and a return to year-over-year growth in the fourth quarter. Our Services business remained strong, growing 8% for the full year.

Looking at revenue from a geographic perspective. The Americas declined 1% and EMEA declined 3% for the year. However, Asia Pac grew 13% in 2017. For the full year, Strategic Enterprise posted growth of 4%, Cloud declined 1% and Telecom / Cable was flat. In reviewing our top 10 customers for the year, 4 were Cloud, 5 are Telecom / Cable and 1 was Strategic Enterprise. Of these customers, 2 were located outside of the United States.



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Non-GAAP gross margin of 62% declined 120 basis points year-over-year, primarily due to lower volume, product mix and higher memory costs, partially offset by improvements in our cost structure and service margins. In 2017, we continued to focus on disciplined operating expense management, resulting in a non-GAAP operating decline of \$17 million or 1%. Non-GAAP operating expense as a percentage of revenue was 39.1%. For the year, we had strong cash flows from operations of \$1,260,000,000, up \$153 million from the previous year. We repurchased \$720 million worth of shares and paid \$150 million in dividends.

Before we move on to Q&A, I would like to provide some color on our guidance, which you can find detailed in the CFO commentary available on our website. Our Q1 revenue outlook reflects ongoing deployment delays as we expect our large Cloud customers to continue their architectural transition. This is expected to result in below-normal seasonality for the first quarter. As Rami discussed, this architectural transition is related to the evolution of these customers' networks to be more automated, cost-efficient and scalable. Despite this outlook, we remain confident in our competitive position and strong relationships with these strategic customers. While the timing of the architectural transitions we are experiencing is dynamic and somewhat uncertain, we expect revenue to grow on a sequential basis beyond the first quarter and a return to year-on-year growth by the end of the year.

We expect gross margins for the quarter to remain under pressure due to lower volume and product mix, resulting from our customers' architectural shifts. There are many factors that impact gross margins. And while it is a dynamic environment, we expect full year margins to improve directionally from Q1 levels. We are undertaking specific efforts to address the pressure on our gross margins. These efforts include value engineering, optimizing our supply chain, pricing management and increasing software and solution sales. Despite the reset of variable compensation and typical seasonal increase of fringe costs, we expect to manage our operating expenses prudently and to increase operational efficiencies both in the first quarter and throughout the year.

For 2018, we expect a non-GAAP tax rate on worldwide earnings to be approximately 21%. The reduction in the projected tax rate is primarily driven by the change in the U.S. corporate income tax rate under the U.S. Tax Cuts and Jobs Act, partially offset by the net increase in the current tax of certain foreign earnings mandated by the act. Following the adoption of the U.S. Tax Cuts and Jobs Act, we plan to repatriate approximately \$3 billion. We expect the new territorial tax system to provide us lower-cost access to nearly all of our global free cash flow on an ongoing basis. We intend to use the repatriated cash to invest in the business, support value-enhancing M&A and fund our return of capital to shareholders.

I'm pleased to report our Board of Directors have approved a new \$2 billion buyback authorization, including our intent to enter into a \$750 million accelerated share repurchase agreement. In addition, they declared an increase of our quarterly cash dividend to \$0.18 per share to be paid this quarter to stockholders of record. This reflects an increase of 80% compared to previous quarterly dividends.

In closing, I would like to thank our team for their continued dedication and commitment to Juniper. Now I'd like to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Tal Liani from Bank of America.

Tal Liani - BofA Merrill Lynch, Research Division - MD and Head of Technology Supersector

Last quarter, you had an issue also with some Cloud customers. What I'm trying to understand this quarter is when it comes to your guidance, can you distinguish between what could be perceived as share loss, maybe architectural decisions of customers that are not -- at least not for now, doesn't fit your portfolio and between just spending issues. Because in your commentary, you spoke mostly about spending rather than your own kind of situation within customers.



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

Tal, it's Rami. Let me start. So the message that we delivered in the last quarter's earnings call, which is very much around confidence that we're both in the starting and ending phase of this architectural transition that we're going -- that we're seeing with our Cloud customers, remains absolutely consistent here and now. So we fundamentally believe, based on the customer conversations that we're having, the work that we're doing on certifying certain products, the software that we're developing that has certain capabilities and features that are very much desired by our Cloud customers, including the largest hyperscale customers, all lead us to have confidence that we will benefit from the recovery. So while it doesn't feel great to be right now in this situation where we're in the middle of this transition, I do firmly believe that we will benefit from the resumption in spending by cloud providers in a new architectural approach that is very different than the starting approach, one that is characterized with scale out, one that leverages a new product, which is the PTX. Very fortunate and happy that we have a technology like the PTX that can capture this transition and ensure that we maintain and even expand our footprint. So the net of it, Tal, is I remain very confident that we will benefit from the resumption in spending and that this is not about a loss of share or footprint to the competition.

Tal Liani - BofA Merrill Lynch, Research Division - MD and Head of Technology Supersector

If I can ask one more question, just shifting gears to the MX. You speak about the PTX. In the past, the MX was very strong. Are you talking less about the MX now because of risk of competition with Arista? Or is it more about carrier spending -- characteristics of carrier spending?

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

Yes, the MX is probably one of if not the most successful routing platforms that's ever seen the market across cloud, enterprise, telecom operators. It's just in a different phase of its life cycle than the PTX. The PTX is a newer product. I think many of our customers across verticals, but especially in the Cloud vertical, see the benefits of having what we have described as a super core or a lean core architecture that enable them to deal with the incredible growth of traffic in their network at a very cost-optimized form factor and price point. And for that reason, we have seen a transition, and we'll continue to see a transition with cloud providers from MX ports to PTX ports. That does have -- put deflationary pressure on a pricing standpoint, per port basis. But the good news is, if you look at the cloud provider businesses that they have, if you look at the growth in the traffic that they are seeing, eventually I believe this pays off for us because we maintain the footprint and can capture that growth, albeit with a different product, which is the PTX. The MX, in other verticals, so take telcos and enterprises for that matter, I think that transition to a PTX is not going to happen anytime soon. It's going to be limited to a relatively small number of use cases. Because typically, where the MX is used in a telco scenario or an enterprise scenario, you're leveraging far more than IP packet transport. You're using its service delivery capabilities that just don't lend themselves to a migration to lean core architecture as easily. So most of that transition is going to happen in the cloud space. And a lot of that transition, as I mentioned in my starting commentary, is behind us already.

Operator

Our next question is from Simon Leopold from Raymond James.

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

Just one quick clarification before I ask my question. You've guided the share count for March to 360 million shares. What assumption are you making in that number for the buyback? Is that the full \$750 million accelerated that you're assuming? I just want to make sure I understand that.

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

Yes, this is Ken. So there are really 2 factors. One is we did just come off of a Q4 where we did \$330 million of share repurchases. So we were opportunistic in Q4, so we're actually ending the year with less shares than we anticipated just 90 days ago. And the second factor is one you



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mentioned, is the ASR. So we're factoring in the impact of the ASR. You don't get full retirement immediately, but you get the majority of that impact in Q1.

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

So we should think about that even without assuming anything beyond that, the share count should be lower also in the June quarter then, when you get the full impact, correct?

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

Yes, the majority will happen in Q1. There'll be a follow-up impact in Q2, and it'll stay throughout the rest of the year at those lower levels.

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

Great. So the question I want to ask is I know a difficult one to answer, but it's pretty key for, I think, folks to be able to understand this transition product cycle around PTX adoption versus MX. And so you have, I guess, some substitution in your Cloud vertical. We're often asked what's the price difference between a PTX and an MX. And so we know the per port pricing is lower. You just mentioned that, Rami. Can you help explain this and how people should think about modeling when you've got this kind of product transition where there is ASP pressure but probably some change in the number of ports that would be shipping in this transition?

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

Yes, I appreciate the question, Simon, and it is a difficult one to answer. So honestly, I'm not going to answer it. I will say the following, which is that there is a meaningful price difference between the PTX and the MX. And you have to think of this from the standpoint of we've been talking about the fact that routing and switching are essentially kind of blending over time. And the PTX is a perfect example of that manifesting itself in a new product. So there is a meaningful price difference. But where it's used, typically, it's used in areas where there is tremendous scale and massive increase in traffic. And that's what we're seeing in the cloud provider space. So I can tell you that although overall revenue in the cloud providers is going to be under pressure as we go through the transition, we are going to be selling substantially more ports, albeit PTX ports and, in some cases, QFX ports than we did with the MX product historically.

Operator

Our next question is from Jeff Kvaal from Instinet.

Jeffrey Thomas Kvaal - *Instinet, LLC, Research Division - Analyst*

I guess 2 questions, if I may, one, Ken, for you, I think. Could we delve into the gross margin issue a little bit? To sharpen the question a little bit, in early 2016, you were delivering not that different revenue, \$1.1 billion or so. And yet, the gross margins were I think 600 basis points higher than they look likely to be this year, 2 years later. So that's a big shift, and I'm wondering if you can help us unpack that. And then for Rami, you mentioned M&A. And obviously, that was a little bit of a topic both on the -- on what you may be interested in purchasing. And also of course, there is a whole slew of Nokia discussions in December. So any comments that you have related to M&A would be helpful.

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

Sure. So I'll take the gross margin question first. So there are many factors that impact gross margin as you know. And as it relates to the guidance of 58%, plus or minus 1%, the Q1 guidance, really I think the easiest way to explain it would be to kind of bridge it from the Q4 levels. So think the



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63.5, 62 kind of level. Really, there are 3 primary drivers in the decline, all of which are putting pressure on the margin itself. The first one is lower volume. So the revenue guide is a couple hundred million less than the Q4 level. So that does have an impact on gross margin when you do that bridge. It's just a factor of fixed costs as a percentage of total revenue. The second factor is really the continuing product technology mix. So we've been talking about technology mix for a while. Think routing to switching. As Routing is actually taking a bigger burden of the revenue decline, as a percentage of our total revenue, Routing is down, and that's also having a headwind to margin. And last but not least would be actually product mix within Routing. So we talked a lot about the architectural shifts, and a lot of that is MX to PTX from scale up to scale out architecture. While the PTX margins are very healthy and actually above the corporate average, they are below our MX margin. So I do think that's another contributing factor into our margin guide. As Rami mentioned, it is important to note that some of that is behind us. 50% of our PTX ports -- or actually substantially more than 50% of our PTX ports that we shipped in '17 to the Cloud vertical were PTX ports, I should say. So that's a good story. We do expect margin to directionally be up. We think the full year levels will be up off this Q1 guide.

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

Jeff, let me answer your first question -- or your second question around M&A. First, let me say that the fact that we've put in place a -- what we view as a good capital allocation policy and strategy now, it should be a sign that we have confidence that some of the challenges that we're going through right now in terms of this architectural transition are, in fact, transitory. Having said that, I think we have a healthy balance sheet, especially now with the repatriation of foreign cash. And I have been consistent in saying that we will continue to look for value-enhancing M&A, and it would be very much in areas that would accelerate our existing strategy. I don't believe that we need a new strategy. We've developed a strategy that very much respects the major trend that's happening in our industry, which is around the cloud. This is not just about serving the cloud providers, but helping our telco customers and enterprise customers in moving to a multicloud environment with easy management, automation and security. So these are sort of the areas that we would look for to accelerate the -- our execution with value-enhancing M&A that we're already working on today.

Operator

Our next question is from Ittai Kidron from Oppenheimer and Company.

Ittai Kidron - Oppenheimer & Co. Inc., Research Division - MD

I wanted to dig in again into the gross margin, and maybe you can give us some color on the impact of volume on margins. How much of the fact that you missed the -- that you're missing the cloud volume is impacting pricing of other products? Meaning, are you now at a point where volumes that you're purchasing from suppliers are below level such that pricing of the components that you buy is rising?

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

Yes. So I mean, volume as it relates to our fixed cost versus variable cost is a big factor. I list it as the first primary factor, but it's really not impacting our purchasing power and our contract manufacturers. We have longer-term contracts with our contract manufacturer providers, and it doesn't have a quarter-to-quarter impact based on volume. So when I mentioned volume here, I'm really alluding to our actual standard margin is higher than our average gross margin because of some of the fixed cost components that get included into the gross margin math.

Ittai Kidron - Oppenheimer & Co. Inc., Research Division - MD

Okay. And then second, just a follow-up on the tax rate, the 21%. I would have hoped it would be lower. I guess I'm trying to understand why not just by blending the mix of your operating profits, international versus U.S., you won't get to a lower rate. Can it go lower from here, or this is the level set following the tax rule?



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

Yes, this is the level we're going to -- we expect given the new tax rule. The big difference to, put just simply, the blended approach that you mentioned is we're actually going to have a U.S. tax on interactional earnings of roughly 10% in the new tax reform rules. So I think that's probably the piece you're missing. So that results in the 21% expectation for this year.

Operator

Our next question is from Tim Long from BMO Capital Markets.

Timothy Patrick Long - *BMO Capital Markets Equity Research - Senior Equity Analyst*

2 questions, if I could. Can you talk a little bit about the switching area and the transitions going on there? Maybe just give us a little color on the move to 100G and maybe a little update on how you're doing on core as opposed to the edge market. And then separately on the telco vertical, just the traditional telcos. It sounds like that was pretty decent in the quarter. Rami, could you just talk a little bit about what you're expecting from that vertical as operators start to set their budgets for 2018?

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

Certainly, Tim. So we'll start with Switching. So our Switching business first has 2 components to it. There's the campus business and the data center business: first being the EX product line; the second, the QFX. We've said now that the QFX has exceeded the EX. So data center dominates the use case that we are pursuing and where the business momentum is. We're very pleased with our all up Switching business growth last year and, in particular, the QFX which grew 25% year-over-year. And if you break apart the QFX business, it has a broad-based component that feeds its way into large enterprises, telco, data centers and smaller type cloud providers that has consistently had solid momentum throughout last year. And I expect it to have that momentum through 2018 as well, growing at essentially double-digit year-over-year growth on a consistent quarterly basis. Then there is a much more concentrated hyperscaler component to our QFX business, and that's going to very much follow the transition from 40 to 100 gig that we've talked about over the last couple of quarters. So there is going to be some cyclical to the QFX data center business as we work through this transition. And I do think that there is an opportunity for us to break into more hyperscale switching opportunities throughout the year. I mean, that is a big area of focus for us. On the telco side, it's really more of the same in terms of market dynamics. I think our telco customers continue to run their networks harder and are getting more comfortable with that. They themselves are moving towards cloud-oriented service delivery models, and we leverage that with products like Contrail, our switching portfolio and our virtual network functions. There is -- there are some headwinds due to M&A and consolidation that's happening in the telco space. So we're not expecting any breakthrough growth from telco anytime in the near future at this point. Looking out a little bit further as you get into 5G, as you get into the buildup necessary to support 5G traffic especially in the metro, I do view that as an opportunity. But we have to sort of temper our expectations because I do think that this market is going to be somewhat challenged at least for the foreseeable future.

Operator

Our next question is from Paul Silverstein from Cowen & Company

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

A couple questions, if I might. First off, if you all said it earlier, my apologies. But Rami, Ken, any share losses whatsoever beyond the architectural transition that you all cited?



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

Sorry, are there any share losses whatsoever?

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

Beyond the transition.

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

Let me say this. I know this is sort of top of mind for all of you guys. But I will -- I am very confident that where we have the major footprint across our large customers, especially in the cloud space, I feel like we have the right customers around, the technology and understanding of what's required to maintain that footprint and to continue to grow in that footprint, and not only that, to actually expand into new opportunities. So it's not just a game of defense where we're trying to hold onto what we have and leverage the growth in those areas. But we are very much playing offense and trying to steal footprint away from the competition. That's the way I view the competitive landscape today. Since joining Juniper now over 20 years ago, I can tell you that the one constant element to that period of time has been it's a very competitive landscape across all of our vertical market segments. And we're comfortable operating in a very competitive landscape.

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

Rami, I appreciate that. But just to be clear, relative to the architectural transition that you're citing in terms of the near-term weakness, you don't believe that you all had any meaningful share losses at those several hyperscale customers -- the several Cloud customers?

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

Yes, I agree with what you just said. We do not believe so.

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

All right. And 2 quick questions, if I might. You cited an increase, I believe you said, on a normalized basis excluding the Cloud architectural transition for PTX. I'm just a little bit confused. I would think -- it sounds like PTX, or at least I thought it, PTX wasn't impacted, is actually going to benefit from the architectural transition but on the come as those folks displace MX with PTX. So why was PTX an issue in terms of you're citing it on a normalized basis, with the implication being that it declined year-over-year not normalized in terms of full impact? And then, Ken, a question for you on OpEx. I think I heard you say you'll manage OpEx prudently or efficiently throughout the year. Can you translate that for us in terms of your expectations for the year? Should we expect OpEx to be flat, to be down, to be up modestly? Any insight you could provide would be appreciated.

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

Yes. Paul, let me start with the PTX question, and then, Ken, you can jump in with the OpEx question. So I'm not concerned at all about the performance of the PTX in 2017 and going into 2018. There will be lumpiness to the PTX that are very much tied to large-scale deployments in the cloud provider space especially. But all up, I mean, Q3 was a record quarter for the PTX. Looking at the opportunities that we're working on with the large hyperscalers as well as some telcos, there is an opportunity to see meaningful growth in the PTX this year relative to last year. So I'm much less concerned about what this is going to do on a quarter-to-quarter basis and much more looking at the opportunities that we've won already and the buildouts that are already in progress.



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

Yes. From an OpEx perspective, first of all, I just want to note, we are pleased with our Q4 results. I mean, we did come in below the low end of our guidance range primarily due to our headcount-related costs as well as some lower variable compensation. As we look ahead, we're not going to provide full year guidance. We did provide Q1 guidance of \$485 million, plus or minus \$5 million, which is even with the fringe reset as well as the variable comp reset. I think that shows you that we are very focused on OpEx discipline, and we remain disciplined. We are -- over the long term, we're looking to expand operating margins. In a down revenue environment, I would say that we will also manage OpEx down. We're not going to be able to perhaps match it one for one, but we are going to be very focused on OpEx as we move throughout the year and we see the revenue start to hit the quarters.

Operator

Our next question is from Steve Milunovich from UBS.

Steven Mark Milunovich - UBS Investment Bank, Research Division - MD and IT Hardware and EMS Analyst

Rami, did the timing of this architectural shift change in the last quarter? I think last quarter, you were talking about the Switching side coming back relatively quickly. And you did see sequential growth. But I don't know if it's coming back as quickly as you expected, and similarly, if the Routing is now extending out weaker, deeper into the year than you previously thought.

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

Yes. It's a good question, Steve. I don't think that it's playing out exactly as we had expected. I think that when you're trying to do forecasting in -- on a set of products that have a very high degree of customer concentration, you only need to sort of get it wrong for a couple of customers to get the overall forecast wrong or the timing wrong. So generally speaking, based on our Q1 outlook, it's fair to say that the transition has taken a little bit longer than what we initially expected. Having said that, we're no longer sort of at the beginning of the transition looking out and trying to predict it in that way. We're sort of in the middle of it. And you can see that just from the port mix that we're now selling into the large cloud providers today, where the PTX has already exceeded pretty substantially the MX ports that we're selling into that market segment.

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

Yes, I would just add, I mean, I do think we expect Switching to be a growth driver for us. We expect Switching to return to growth in the second half and actually beat full year growth for FY '18. We're also very pleased with the momentum we're seeing in Security. We had our first year-on-year growth quarter in a while. And we expect FY '18 to be a year of Security growth for us on a full year basis. But Routing, given the transition and the difficulty in coming -- understanding when it's going to come back and when it's going to come back in enough volume to offset some of the headwinds, I think it's reasonable to expect Routing to be down on a full year basis in FY '18.

Steven Mark Milunovich - UBS Investment Bank, Research Division - MD and IT Hardware and EMS Analyst

The growth in Asia Pacific, was that new insertions? And do you expect growth to continue?

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

I'm super proud of our APAC team for the momentum that they've demonstrated over the last couple of years in what is a very competitive landscape. And I do think that there are opportunities to continue the momentum into 2018, yes. We've been talking now for the last year about strategic insertions and, in particular in China. And our expectation is that those will start to pay off at some point this year.



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Operator

Our next question is from Patrick Newton from Stifel.

Patrick M. Newton - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP and Senior Analyst*

I guess I'm trying to piece together your goal of returning to year-over-year growth exiting the year and weigh it against Security growing year-over-year, Switching growing year-over-year and then Routing not growing. So is it right to think that return to -- end of year growth is really at the 4Q time frame? And up to 3Q, year-over-year growth are very small? And once this transitory architecture headwind is complete, it sounds like even with your Routing outlook, that we should expect only tepid year-over-year growth in 4Q. Just want to make sure I'm kind of piecing together all the parts correctly.

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

Yes. Yes, no, I would look at it as when we talked about sequential growth and then returning to year-on-year growth by the end of the year, I would think Q4 is the right time frame. And that's all up. That's an all up comment, not necessarily particular to any technology. We do think the Routing transition, although we're -- I would phrase we're in the middle of it, there is still a fair amount of disruption that's going to cause to the FY '18 numbers from a Routing perspective as we continue to finish up the transition and hopefully set us up for growth beyond this year. But I think this year, Routing, we expect to be down given the current visibility we have and our expectations of the timing of the transition.

Patrick M. Newton - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP and Senior Analyst*

All right. Then taking that answer and starting out with your 48 -- or 58% gross margin in March and marching up sequentially through the year, is it fair to assume that given the impact of greater PTX and switch mix that gross margin in 4Q '18 would still likely be below your 4Q '17 levels?

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

Yes. Again, not going to get that specific out 4 quarters. I'm really focused on making sure we get our more visible quarters predicted correctly. I will say this. I do think that we expect revenue to grow. Therefore, I think it's a reasonable assumption that we're making that the margin should also grow directionally. I want to make sure that, there is going to be deal mix and customer mix that's difficult to predict when you get out to any particular quarter. But we do believe margins should recover from the Q1 levels by the time we exit the year.

Operator

Our next question is from Vijay Bhagavath from Deutsche Bank.

Vijay Krishna Bhagavath - *Deutsche Bank AG, Research Division - VP and Research Analyst*

My question is really around competition in routing as we head into 100 gig and perhaps 400 gig routing from suppliers such as Arista in particular. How would you compete in a situation where your competition would use high density 100 gig, 400 gig port platforms? Would the competition be in feature performance, perhaps pricing? So help us understand the competitive strategy in routing as new entrants come into that marketplace.



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

Yes. Thanks for the question. Again, I'll just reiterate that routing has always been an incredibly competitive market. And we recognized several years ago that in order to continue to compete effectively in the routing space, we're going to need to have a new breed of routing platform. And that's when we conceived of this idea of a lean core architecture, which is defined by this product that we call the PTX. It's a good thing we did that because I think our situation today would be very different if we did not have that product and the ability to transition what is the most demanding customer, our Cloud customers, toward this new lean core architecture. That said, so I think that the concept was right, the execution was right on. Now all we need to do is to ensure that we maintain the competitive differentiation on an ongoing basis, and we will do that with the road map that we have in terms of software technologies that give our customers the ability to obtain telemetry and information from these systems, which is extremely important to the cloud in particular, to enable logical scale that is best in class across the industry today. And our goal is to ensure that, that is -- it stays that way in the future. And increasingly with optics, I think that the investments that we're making in the optical space is essentially a way for us to compete on the economics of networking beyond just the IP-based routing but the integrated optical technology that I think is becoming more and more important to our customers. So I'm -- all of this is to say that I'm very confident that we have the right investments in place and the innovation to deal with a very competitive environment in routing.

Operator

Our next question is from Aaron Rakers from Wells Fargo.

Aaron Christopher Rakers - Wells Fargo Securities, LLC, Research Division - MD of IT Hardware & Networking Equipment and Senior Analyst

Two real quick ones if I can. Just going back to the guidance and the ability to kind of return to growth exiting the calendar year. Aside from kind of port shipment transitions or inflections within your large Cloud customers, I'm curious, are you assuming in that scenario that some of your Cloud customers reach the inflection from a revenue standpoint in terms of the MX to PTX router transition? And then I have a quick follow-up.

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

Yes. I just want to clarify. The sequential growth that we are expecting and the return to year-on-year growth is not a particular customer set or a particular technology. It's really more of a Juniper overall revenue. We do have a broadening base in our Switching business that Rami mentioned, where we're seeing a lot of very consistent growth, double-digit growth in fact if you normalize for the hyperscalers within the QFX. We believe Security can continue to grow consistently going forward. We're still in a bit of a turnaround there, but we're seeing signs of growth there and expect growth for FY '18. So the comment I'm making is not particular to this transition. It's more -- it's broader than that.

Aaron Christopher Rakers - Wells Fargo Securities, LLC, Research Division - MD of IT Hardware & Networking Equipment and Senior Analyst

Okay. Fair enough. And then just on the gross margin line again, looking at the guidance of 58%, plus or minus, in the quarter, it looks like you're guiding more or less product gross margin to be in that mid-50% range. First of all, am I correct in that assumption? And second to that, do you believe that as you kind of transition, that gross margin on the product side can get back to a 60%-plus level?

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

Yes. So we don't break it out for you, but I will say that it's -- the service business does carry a fair amount of people cost. And the reset of variable comp and fringe will have an impact on our service margin as well. I'm not going to give you the specifics, but I do think there's going to be a bit of decline in both for Q1 off of Q4 levels. Back to the longer-term margin, there's a lot of factors. I think we talked a bit about what we're doing internally. There's a big focus internally on innovation and making sure we do the value engineering work. We need to be cost competitive. Optimizing the supply chain is something we continue to focus on. Pricing discipline, is I know -- I know the field is rolling out a new pricing discipline. I think it's going to pay off for us in the long run, as well as just increasing our software and solution sales. There's a lot of efforts underway



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to return the margin to growth. I also think probably the biggest single factor is going to be getting through this transition. Although the margin impact is largely being felt now, this quarter, and perhaps over the short term here, as we get through this transition, I think that will give us the opportunities to grow margin beyond these current levels.

Operator

And we'll move on to the next question from Mitch Steves from RBC Capital Markets.

Mitchell Toshiro Steves - RBC Capital Markets, LLC, Research Division - Analyst

I know you guys can't provide the exact number, but just to get a handle around kind of full year revenue. So for the entire company, if Routing is going to be down, just given the material miss for the first quarter, is it fair to assume the entire company revenue should be down on a year-over-year basis for '18?

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

Yes. I think our expectation is to grow sequentially and return to growth late in the year. I believe it's reasonable to model that it could be a down year in full year revenue basis based on what we see now, predominantly because of the Routing shortfall.

Operator

Our next question is from Mark Moskowitz from Barclays.

Mark Alan Moskowitz - Barclays PLC, Research Division - Research Analyst

A question and a clarification. On the clarification, when you talk about the return to year-over-year revenue growth ending '18, is that predicated more on new logo penetration versus recovery in your existing logos? And then Rami, for you, on the Cloud re-architecting here, that transition, when the transition is over, is there any risk that you could actually see less content sold into each environment or provider because of their efficiencies that they're trying to achieve?

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

Okay. So let me answer the second one first on the Cloud transition. This kind of pricing inflection point that is happening from the MX to the PTX is not one that I expect to happen again anytime in sort of the foreseeable future in the Cloud or anywhere else. I do think that what we're seeing now is somewhat unique just by virtue of the fact that there is truly this architecture shift that's enabled by a new breed of routing platform that blends the line with switching. And that just doesn't happen all that often. So I think once we get through it, assuming that the cloud provider, especially the large hyperscalers, will need to continue to deal with growth in their businesses, which I would bet is the case for years to come, then we will benefit from that exiting 2018.

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

Yes. From a customer perspective, I mean, the answer is both. I mean, we focus on growing our current customers both as they grow as well as getting new footprint into existing customers. And clearly, we have a big focus on new logos as well, expanding our customer base, particularly in the enterprise and some of those verticals where we have opportunity to expand further.



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Operator

Our next question is from Jim Suva from Citi.

Jim Suva - Citigroup Inc, Research Division - Director

I believe back in 2017, in the early part of the year, the cloud was a big beneficiary to you, if my memory is correct. And then the second half unfolded, and it became a bigger headwind, preannouncement lowering. And now you're talking about visibility as people transition through this architecture. So I want to kind of take a look back and see if -- did you see this second half headwind coming? And if so, that's great. If not, just let us know. But also, what type of confidence do you have that this transition will come to pass, where you're going to come out of this okay? Because it seems like the second half of the year was much worse than expected.

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

Yes. It's a good question. I think that it's true. We have been benefiting from Cloud growth now for several years, right, not just in the first part of 2017 but even for a few years behind that. As a result of that strength, we saw our market share in core routing, in particular in North America, start to grow meaningfully over that time period. What we're doing now, I know it sort of feels painful, and it's not the most fun thing to do from a quarterly results standpoint. But it is absolutely the right thing to do. We're essentially making sure that we disrupt ourselves and maintain the footprint that we have built to date so that we can benefit from the next wave of spending by the cloud providers. I mean, that's what it really comes down to. As far as our ability to see it, we certainly saw it at a macro level because we built products for it, right? But did we predict the timing and the magnitude of the disruption in the transition? I'd say no. I don't think we predicted either of those things as well as I would have liked. But I think the most important thing is I have the confidence that we will benefit from maintaining the footprint that we have as we get back into growth, and there is absolutely this goal that I mentioned earlier to expand into new opportunities and new footprints among the cloud providers, in particular in the data center.

Operator

And our next question is from James Kisner from Loop Capital Markets.

James Martin Kisner - Loop Capital Markets LLC, Research Division - SVP

So just sticking with your customer segments, Strategic Enterprise, I mean, obviously, that's pretty strong result there, acceleration. Were there any large deals that helped that? I'm just kind of wondering if we should expect that elevated growth rate in that segment to continue?

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

Yes. So I'm actually very pleased with the momentum that we've built in the enterprise space in Q4. We saw double-digit year-over-year growth and sequential growth. There has been a concerted effort to really go after new logos. We added 3,500 new enterprise logo in the 2017 time frame, and I believe that will continue. It's not -- there is a little bit of customer concentration, but for the most part, it's broad-based. And we are definitely innovating in a way that makes us more relevant to the enterprise with the goal of diversifying our business more in the enterprise space. And just to give you an example of that, Contrail, which has been the SDN controller that we've developed initially primarily for large cloud and telco customers is now essentially being repackaged in a way that solves some very meaningful enterprise problems, in particular multicloud management and multicloud securities. The feedback that we've gotten thus far on this product direction has been phenomenal, and we see some real opportunities to maintain if not increase the momentum in the enterprise space with these technologies.



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Operator

And our final question comes from James Faucette from Morgan Stanley.

James Eugene Faucette - *Morgan Stanley, Research Division - Executive Director*

I just had a couple of questions. First, and I recognize the difficulty in trying to forecast margins a year out. But can you just help us think about like what the puts and takes would be that would allow you not only to return to revenue growth year-over-year by the fourth quarter but potentially even be flat or maybe up a little bit from an earnings perspective? And then maybe more broadly, for both Rami and Ken, is that you talked about you want to be seen as and you feel like you want to be aggressive in new opportunities. But right now, you're continuing to manage OpEx, and it's continuing to decline as your revenues are pressured. But all of your competitors around you are increasing their R&D to attack a lot of the same opportunities you're eyeing. So at what point, either from a time perspective or a revenue recovery perspective, should we expect you to start to match some of your competitors in terms of increasing your investment in R&D, et cetera?

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

James, let me start with the question around investments. And then Ken, I'll let you address the first question. I'm an R&D guy. So I spent many years here developing the technologies, many of which are in the market today. So I have a good feel for this. And I think that we have the right investments in the right areas. The key is focus. The key is ensuring that we remain incredibly focused, in particular on the cloud opportunity, and we're developing the technologies that make us even more relevant towards that opportunity across all of our key market segments. R&D investments as a percentage of revenue for us is actually quite healthy if you compare us to our peers. So the net of it is I'm not concerned about our ability to invest in the areas in a very focused manner to maintain our competitive differentiation across all of our technologies.

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

Yes. And from an earnings perspective, clearly, our goal is to grow earnings over the long term. Given the kind of color we provided on both revenue and gross margin as well as OpEx for the year, I think it is reasonable to presume that EPS will be down on a full year basis unless we see a stronger recovery to revenue than we're currently projecting in our models. From a -- does it get to positive in Q4? I think that's clearly -- it's too early to call at this point. Clearly, our goal is to get to earnings growth sooner rather than later.

Operator

This concludes the question-and-answer session. I'd like to turn the floor back over to management for any closing comments.

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

Thank you, everyone, for your questions. We look forward to speaking with you next quarter.

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

Thank you.

Operator

Thank you for your participation. You may disconnect your lines at this time. Thank you again. Have a nice day.

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