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JNPR.N - Q2 2022 Juniper Networks Inc Earnings Call

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## OVERVIEW:

JNPR reported 2Q22 total revenue of \$1.27b and non-GAAP EPS of \$0.42. Co. expects full year 2022 revenue to grow approx. 10% and 3Q22 revenue to grow approx. 14%.

## CORPORATE PARTICIPANTS

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

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

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## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen, and welcome to the Juniper Networks Second Quarter 2022 Financial Results Conference Call. (Operator Instructions)

It is now my pleasure to turn the floor over to your host, Jess Lubert, Vice President of Investor Relations. The floor is yours.

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

Thank you, operator. Good afternoon, and welcome to our second quarter 2022 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 and CFO commentary furnished with our 8-K filed 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. (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 Q2 2022 results. We delivered strong top line results during the June quarter as total revenue of \$1.270 billion exceeded the midpoint of our guidance, and product revenue saw a second consecutive quarter of double-digit year-over-year growth despite ongoing challenges from a supply chain perspective. Demand remained strong and exceeded our expectations, with product orders seeing double-digit year-over-year growth when adjusted to account for extended lead times.

While gross orders experienced a single-digit year-over-year decline, this was better than expected given the difficult comp in Q2 of last year when the duration of customer orders began to extend. Total product backlog increased meaningfully on both a sequential and a year-over-year basis to end at a record level, setting us up well for Q2 revenue growth as this backlog eventually begins to normalize.

Our focus on delivering solutions that improve customer operations, what we call Experience-First Networking, continues to resonate across each of the markets we serve. This is evident in our Q2 results, which saw year-over-year revenue growth across all customer verticals. Demand signals remained healthy, and we are seeing attractive opportunities across our enterprise, cloud and service provider markets.

With that said, we are particularly encouraged by the Q2 momentum in our enterprise business, which not only delivered a record revenue quarter, but also saw orders increase by 20% year-over-year. We believe this strength is reflective of our sustainable differentiation in technology and user experience, both in our campus and our data center offerings as well as the investments we've made in our go-to-market organization.

We believe these factors should enable us to gain share and deliver sustainable enterprise growth in future periods, even if macro headwinds start to affect our markets. Another highlight in the quarter was the increased diversification within our cloud vertical, where we saw improved momentum with multiple hyperscale providers and continued success with cloud major accounts, both of which are adopting our 400-gig technology.

Of our top 10 customers in the June quarter, 6 of them were cloud accounts, which illustrates the diversification we are seeing. We view our increased cloud diversification as a positive development, which should position this business for sustainable long-term growth. Not to be overlooked, we continue to see healthy momentum in the service provider vertical and just recently secured a new 400 gig core win with one of the Tier 1 U.S. carriers. We're also making progress in the metro market, where we recently introduced several new platforms that will further enhance our competitive position in this attractive portion of the market. Our teams are executing well, and we continue to feel good about our ability to capitalize on big opportunities tied to enterprise digital transformation and cloudification initiatives, 400-gig upgrades at cloud and service provider customers and the broader adoption of cloud-based services and network architectures.

Based on my conversations with customers, these opportunities represent key strategic initiatives that should present a durable tailwind for our business over the next several years. While revenue was a bright spot and customer demand remained strong, margin and EPS came in weaker than we expected due to higher-than-expected supply chain costs and lower-than-expected perpetual software revenue, both of which I'd like to address.

First, from a supply chain perspective, the availability of parts remained extremely challenged during the June quarter as we saw a meaningful uptick in the volume of supplier decommits. In order to secure access to additional parts and get products to customers as soon as possible, we incurred higher costs than we anticipated at the beginning of the quarter. While some of these actions will impact profitability over the next few quarters, they are also enabling us to access more parts and better satisfy customer demand which should have positive longer-term implications for our business.

Secondly, our software revenue mix came in lower than we expected, even though software revenue still grew 24% year-over-year. We believe the outlook for our software business remains strong, and we are encouraged by the momentum we're seeing with our Junos-based Flex software, off-box subscription software and Software-as-a-Service offering such as Mist. Much of this momentum can be seen in our deferred revenue from customer solutions, which grew 7% sequentially and 41% year-over-year. The truly ratable component of this deferred revenue, which accounts for more than half of the total, grew even faster, nearly doubling on a year-over-year basis.

In summary, demand remains strong. And given the backlog we've built, along with the actions we've taken to secure more supply, we're now incrementally more confident regarding our top line outlook and our ability to ship products to customers. As a result, we now expect to deliver approximately 10% sales growth in 2022 and at least mid-single-digit revenue growth in 2023. While non-GAAP operating margin is likely to be flat to slightly down in 2022 due entirely to the lower-than-anticipated non-GAAP gross margin we now expect, we still expect non-GAAP earnings to grow. We remain focused on delivering improved profitability and expect margin to expand in 2023.

Now I'd like to provide some additional insights into the quarter and address some of the key developments we're seeing from a customer solutions perspective. Starting with automated WAN. We delivered strong results in the Q2 time frame and orders once again exceeded expectations but did decline year-over-year. Revenue grew year-over-year across all customer verticals, all geographies and all major product lines, including our MX, PTX and ACX families.

We're now continuing to see strong 400-gig momentum with our cloud and service provider customers, including the new 400-gig core win with the U.S. Tier 1 provider that I previously referenced. This win was secured based on the strength of our PTX product family, which delivered the superior scale, embedded security and power efficiency this important customer requires. I was also encouraged to see another quarter of strong demand for our newer MX platform leveraging our 306 silicon, including the MX10K, the LC 9600 line card and the MX 304.

These platforms deliver the industry-leading logical scale, embedded security and power efficiency necessary to meet the needs of the most demanding multi-service edge environment. We also saw another quarter of triple-digit order growth for our ACX Metro portfolio and introduced several new platforms such as the ACX7024 and the ACX7509, both of which provide industry-leading performance and expand the number of metro use cases we can address.

We plan to further enhance our metro portfolio with new hardware, software and automation capabilities in future quarters that will further enhance our competitive position in this attractive portion of the service provider market.

Our cloud-ready data center revenue was flat Q2 due entirely to the timing of shipments. Orders exceeded expectations but did decline year-over-year due to an exceptionally large deal with a hyperscale account in the year ago quarter. Excluding this customer, orders experienced double-digit year-over-year growth, and we continue to see healthy momentum with large enterprise and cloud major accounts. Our 400-gig solutions are resonating in the market, and we have now secured approximately 80 400-gig data center switching opportunities that span across cloud majors, enterprise and service provider accounts.

Customer interest in our cloud-ready data center portfolio remains high. And given the wins we've already secured, I'm optimistic about our ability to capitalize on the attractive growth within this market over the next several years.

Our AI-driven enterprise revenue continued to materially outpace the market, growing 17% year-over-year. This strength was led by our Mistified portfolio, which grew more than 60% year-over-year, achieving another record quarter for both Mist WiFi and Mistified revenue. We are especially encouraged by the traction we're seeing with large customers across the globe with wins at a global financial bank, a global car manufacturer and a global furniture retailer, each of which recently purchased a combination of AI-driven wireless, wired, security and/or SD-WAN products from Juniper.

To build on this AI-driven enterprise momentum, we continue to deliver groundbreaking new products that optimize both end user and operator experiences, such as the recently launched EX4100 family of access switches. Like the EX4400 family announced last year, these are truly enterprise-grade access switches born in the cloud with native AIOps, ensuring easy setup and management, coupled with best-in-class scalability, security and performance. In addition, we brought AIOps indoor location services with recently announced features that simplify wireless access point placement and orientation, and we are now delivering 6th generation AI-driven actions to address even more common networking problems such as DHCP failures and wired authentication errors.

Based on our recent order momentum, third-party validation and the technical superiority of our AI-driven enterprise portfolio, I remain highly confident regarding the outlook of our complete client-to-cloud campus and branch business. Our security revenue declined in Q2 due largely to supply chain constraints on our hardware platforms and a difficult comp in the year ago quarter.

Despite these challenges, we saw healthy momentum in our midrange firewall portfolio as well as our software-only security offerings. We believe the performance of our products is industry-leading, which has been validated by a number of independent tests, most recently receiving a AAA rating from CyberRatings with a 100% block rate for our cloud firewall offerings.

We remain confident in our connected security strategy and believe the convergence of networking and security provides us with a competitive advantage in the portions of the market where we are currently focused. We believe our technical strength in both security and networking will provide tailwinds in future quarters and should enable us to deliver better results over the next few quarters.

I'd like to mention that our services team delivered a record quarter due to strong renewals and attach rates. In addition to strong revenue, we also achieved another quarter of solid service margin. Our services organization continues to execute extremely well and is focused on driving incremental efficiencies through automation and cloud-delivered insights that not only create new revenue opportunities but also benefit margin and the customer experience.

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 our stakeholders.

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

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

Thank you, Rami, and good afternoon, everyone. I will start by discussing our second quarter results and end with some color on our outlook. We ended the second quarter of 2022 at \$1.270 billion in revenue, above the midpoint of our guidance and up 8% year-over-year.

Non-GAAP earnings per share was \$0.42, below the midpoint of our guidance range due entirely to lower-than-expected gross margin. We continue to be in a supply-constrained environment with unprecedented cost to procure components and deliver our products. We prioritized delivering products to our customers as timely as possible, which resulted in higher costs and lower gross margin. Product orders remained strong during the second quarter and exceeded our expectations.

As a reminder, we are experiencing some order strength attributable to industry supply chain challenges, resulting in customers placing orders ahead of their normal order rate to account for the extended lead time. While product orders declined single digits year-over-year due to a difficult comparison, adjusted orders grew double digits year-over-year, and our backlog increased more than \$250 million on a sequential basis.

We saw particularly strong demand in enterprise vertical with both gross and adjusted orders growing on a year-over-year basis. From a customer solution perspective, automated WAN solutions and AI-driven enterprise revenue both grew 17% year-over-year. Cloud-ready data center revenue was essentially flat year-over-year. Looking at our revenue by vertical, all verticals grew sequentially and on a year-over-year basis. Revenue in enterprise grew 15%, followed by Service Provider growing 6% and our cloud business grew 3% on a year-over-year basis. Total software and related services revenue was \$213 million, which was an increase of 24% year-over-year. Annual recurring revenue, or ARR, grew approximately 34% year-over-year.

In reviewing our top 10 customers for the quarter, 6 were cloud, 3 were service provider and 1 was an enterprise. Our top 10 customers accounted for 34% of total revenue as compared to 33% in Q2 2021.

Non-GAAP gross margin was 56.2%, which was below our guidance range, primarily due to elevated supply costs related to the challenging supply chain environment and lower-than-anticipated software mix. We experienced a greater volume of supply de-commitments in the quarter, which resulted in increased expedite and component costs as we prioritize delivering products to our customers as timely as possible. If not for the elevated supply chain costs, we estimate that we would have posted non-GAAP gross margin of approximately 59%. We expect the supply chain environment to remain challenged through at least the second half of the year.

Moving on to operating expense, on a non-GAAP basis, which increased 4% year-over-year and 1% sequentially. Non-GAAP operating margin was 13.9% for the quarter, which was below our expectations due to the lower-than-expected gross margin results. We had \$267 million in cash outflow in the quarter. The cash outflow in the quarter includes approximately \$165 million of additional payments to suppliers and prepaid deposits as well as strategic inventory purchases and an attempt to meet our customer delivery demands.

Approximately \$15 million of lower customer collections related to invoicing linearity and approximately \$75 million of additional cash tax payments related to the capitalization and amortization requirements for research and development expenditures of the Tax Cuts and Jobs Act of 2017, which went into effect on January 1, 2022.

While we expect to be cash flow positive in the second half of 2022, some of these items are likely to also negatively impact second half cash flow results. Over time, we do expect cash flow timing differences to normalize, and our cash flow results should be relatively in line with profit levels. Total cash, cash equivalents and investments at the end of the second quarter of 2022 was \$1.3 billion.

Now I'd like to provide some color on our guidance, which you can find detailed in the CFO commentary available on our Investor Relations website. For the third quarter, we expect to see revenue growth of approximately 14% year-over-year driven by the strength of our backlog, strong demand and an improved supply outlook. Our better-than-expected supply outlook is the result of strategic actions we have taken to improve our access to components.

We will continue to prioritize delivering products to our customers as timely as possible. The higher cost we are incurring to secure supply will negatively impact margins over the next several quarters. In addition, we expect to see a similar software mix in the third quarter as we saw it in the second quarter. These factors will continue to pressure our gross margin and overall profitability.

Turning to our expectations for the full year 2022. Given the strong order momentum we have seen, coupled with our current backlog as well as an improved supply outlook, we are raising our revenue growth expectation for the year to approximately 10%. This assumes the current supply chain environment does not further deteriorate. We also anticipate backlog to remain at elevated levels through the remainder of the year.

Non-GAAP gross margin for the full year 2022 is expected to be approximately 57%, down from our original expectations of 58% to 60%. As a result of the supply chain constrained environment, we now expect to absorb approximately \$155 million of elevated component and freight costs in 2022, more than 50% higher than we had anticipated at the beginning of the year. We believe these elevated costs will be transitory over time.

In addition, software as a percentage of total revenue in the second half of the year is expected to remain close to Q2 2022 levels. In 2021, we implemented some pricing actions which have begun to partially offset some but not all of the increased costs we are incurring. We are planning to take additional pricing actions to further offset these incremental costs. However, given the size of our backlog, these actions will take time to positively impact our results.

We remain committed to disciplined expense management, and we expect operating expense to grow slower than revenue. That said, we will continue to invest to take advantage of market opportunities, and our non-GAAP operating expense is expected to increase on a full year basis. Given the pressure we are seeing in non-GAAP gross margin, we, no longer, have line of sight to at least 100 basis points expansion of non-GAAP operating margin. Our current expectation is non-GAAP operating margin will be flat to slightly down for the full year. We still expect non-GAAP EPS to grow on a full year basis.

While the current global macroeconomic environment and the ongoing pandemic posed some uncertainty, we would like to provide some early color on our outlook for 2023. With the order momentum we are seeing, our elevated backlog and current expectations for supply, we expect revenue growth of at least mid-single digits on a full year basis in 2023. We also expect improved profitability and margin expansion in 2023.

In closing, I would like to thank our team for their continued dedication and commitment to Juniper's success, especially in this challenging environment.

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

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) The first question is coming from Paul Silverstein with Cowen.

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

I hate to ask you about supply chain, but I guess I will. Ken and Rami, what changed? And at the risk of asking you to speak for not just yourselves but other companies, it appears over the last year or 2 to have been somewhat of a randomness in terms of general trend of either stability.

(technical difficulty)

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

And this really forced us to pay more expedite fees and heavily leverage the broker markets more than we historically have, and that comes at a higher cost. So the good news for us is I feel very proud of our ability to navigate these curveballs in these situations. And we actually -- as you saw, we actually beat our revenue midpoint for the quarter. And based on these actions we're taking, albeit they do come at a cost. We feel confident that we are getting access to more supply, and we actually raised our guidance for the full year. So we do see supply improving from an absolute volume perspective, but it is coming at an incremental cost, and it's difficult. I mean every quarter seems to be a different challenge, but we seem to be doing a pretty good job, in my opinion, navigating those challenges.

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

Can you give us a rough idea of how many de-commits you're talking about and how that compares to the previous quarter?

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

Yes. It's difficult to quantify. I'll tell you that we had some large strategic suppliers that we were expecting supply early in the quarter than we received. We received some of it later in the quarter. The other impact that we had was linearity in the quarter from a shipping perspective and invoicing perspective was also negatively impacted. So it was definitely greater than normal, Paul, but we haven't really given these numbers in the past. So it's hard to compare it to historical norms.

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

All right. Can I ask one follow-up. Rami, I think I heard you reference momentum or progress with hyperscalers. Can you give us any insight on -- more granular insight on what you're referring to?

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

I'd be happy to, Paul. So I'm actually really pleased with our results, with our cloud providers all up. I think the name of the game for us in the cloud provider space is diversification. I think we're seeing increased diversification among the hyperscalers, Tier 1 hyperscalers. So if one of our top hyperscale accounts goes through a period of digesting orders that they have placed in the past, what we're finding is another one will step in and compensate for that with more orders. And that happened -- some of that happened in Q2. And then more broadly, our cloud majors customers

saw great momentum and not just in routing, but also in data center switching and in 400-gig opportunities. So all up, I'm very pleased with the momentum we're seeing, and I'm optimistic about the cloud provider vertical going forward.

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**Operator**

Up next, we have Tim Long with Barclays.

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**Timothy Patrick Long** - *Barclays Bank PLC, Research Division - MD and Senior Technology Hardware & Networking Analyst*

Just wanted to talk on the enterprise business, a little bit. So Rami, just if you could talk a little bit, obviously, it's been a great market, good results this quarter. Talk a little bit about kind of the sustainability of the elevated growth there, and a little bit on how you're continuing to invest in go-to-market and how you're pulling through whether it's traditional wired products or some of the SD-WAN or the other new technologies that you're bringing into the enterprise?

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

Yes, I'd be happy to. So needless to say, I'm incredibly proud of the team for the results that they're continuing to deliver in the enterprise segment all up. Very strong growth, both in terms of revenue, but also in terms of orders that grew 20% year-over-year, diversity in terms of the technology offering.

So obviously, we're seeing continued momentum with our AI-driven enterprise solutions, but even our automated WAN saw really great momentum this quarter. And a lot of that was driven by a resumption in spend by the federal government, which was kind of weak for the last several quarters. And I do expect that some of that is going to continue. So I'm actually quite optimistic about that. We are absolutely keeping a close eye on any sort of early warning indicators from a macro standpoint, any sort of headwinds. But so far, and you can see it from the order momentum we're seeing, we're not seeing any of that at this point in time.

And I think the team has done a really nice job of just focusing on more macro resistant segments of the enterprise market. I think that's working in our favor. I also believe that the kinds of technologies that we're offering to our customers, be it cloud-delivered, AI-driven solutions, highly automated data center solutions are the kinds of solutions that I think our customers or prospects view as very strategic to their digital transformation initiatives. And so in -- and of that, I think you're going to see just more resilience to any sort of issues that might come our way in the future. So for all those reasons, technology differentiation, our go-to-market team just crushing it, focusing on the right subsegments of the market, I continue to be very bullish about our enterprise business going forward.

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**Operator**

The next question is coming from Amit Daryanani from Evercore.

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

I guess one of the things that some of the companies have talked about, love to get your perspective is signs that macro starting to impact demand. Are you seeing any of that? I know the European revenues were a little bit weaker, but I'd love to just understand if you're seeing anything in terms of elongation of sales cycles or anything on the macro side. And then just related to that, I'm curious what gives you the confidence in the conviction to give at least an initial framework for calendar '23 this early in the process?



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

Yes. Let me start, and I'm sure Ken would like to weigh in as well. So order strength remains robust. And it remains robust across all of our segments. So I know when it comes to macro indicators, I think people are mostly concerned about what might happen to the enterprise. But you saw their enterprise revenue double-digit growth, enterprise orders growing at 20% year-over-year. We're not going to be immune to any sort of major macro changes that happen, but we've got our early ordering indicators sort of we're sort of scoping and making sure that there isn't anything to be concerned about. And thus far, I'd say there is not.

I think we are playing in markets that are large that where we have relatively small share where there's tons of opportunity for us to compete, and we're competing with solutions that, I think, are very strategic, especially in a situation where there are going to be cost pressures and the need for IT teams to start cutting costs.

So for these reasons, I actually think even in the event that there were challenges, macro-related challenges, we can do quite well. And with that said, I'll just pass it on to Ken for additional commentary.

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

Yes. On the FY '23 kind of framework, over the last several quarters, as you know, we've built up an exceptional backlog. This is definitely providing us much greater long-term visibility than we historically had. Our backlog is now more than \$2.4 billion, which is approximately 6x normal level, so an exceptional backlog build.

Also, the investments we're making in the supply chain, we believe, are starting to pay off. We did raise the full year this year. The second half we raised to get to a 10% full year guide in 2022. And we believe we'll have access to supply to get to at least mid-single digits next year. We haven't provided FY '23 guidance as of yet. The only guidance you kind of have would be our long-term model, which was at least low single digits, which we provided over 1.5 years ago. And we felt at this point, given the demand signals we're seeing, given the supply that we believe we'll be able to procure, we think mid-single digits is the right framework at this time, at least mid-single digits.

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**Operator**

The next question is coming from Rod Hall with Goldman Sachs.

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**Roderick B. Hall** - Goldman Sachs Group, Inc., Research Division - MD

I had two for you. One is just the implied gross margin in Q4. We calculate about 1.3 percentage points, maybe 1.5 percentage points increase sequentially there off of Q3. And I'm just curious what you guys -- what makes you expect that? Is it visibility on costs? Or is it pricing or kind of what the driver is there? And then I have one follow-up.

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

Yes. So without getting specific on Q4, I'm sure your models are pretty accurate, Rod. We do think the year will be about 57%. Really, we expect there to be a volume benefit in Q4. We also expect to see more and more of the pricing actions that we've taken play out as time passes. So those would be the primary factors. Again, I'm not providing specific Q4 guidance. I don't have exact mix prediction at this point, but I do believe 57% for the year is the right place to be right now.

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**Roderick B. Hall** - Goldman Sachs Group, Inc., Research Division - MD

Yes. Just if we plug in, Ken, the Q3 guide, that's kind of what we get, what spits out of Q4.

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

Yes. I'm sure your models are close, yes. I just don't have the model in front of me.

**Roderick B. Hall** - Goldman Sachs Group, Inc., Research Division - MD

Yes. And then the other thing I wanted to ask you is DSOs are up a lot in the quarter. And I wondered if you could comment on linearity in the quarter and also the driver for the DSO is just supply shortage or there's some back-end linearity there as well? .

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

Yes. So linearity in the quarter from an orders perspective was very normal, right? We saw a very strong demand in bookings throughout the quarter, and we really didn't see any sort of abnormally from a linearity perspective. That said, from a shipping and therefore invoicing, we did see a pretty back-end loaded quarter. As I mentioned in my prepared remarks, we had some supplier de-commitments and we had to kind of recover and react to that. So we did ship later in the quarter than we normally do that had an impact on DSO. It had an impact on the cash flow. It also had an impact on freight cost as we had to take faster routes to get products to customers and the commitments we made to them. So it had a negative impact on a few of our metrics.

**Operator**

The next question is coming from Alex Henderson with Needham.

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

So \$2.4 billion plus in backlog is an enormous backlog relative to the historical norms of the company. And as we look forward, if I were to run what the equivalent of a bank stress test on your outlook for CY '23, it looks like you could produce 20%, 30%, 40% declines in orders for the next 3 or 4 quarters and right through to the back end of '23, still hitting at least mid-single digits or plus revenue growth and still end up with a backlog that's 250% to 300% of normal. Is the backlog likely to increase as we go into the back half of the year? And how do you view this -- these year-over-year declines versus the ability to sustain a book-to-bill somewhere in the broad vicinity of 1.0 as we go through the end of the year because that's really the critical variables to the stability and visibility of the '23 numbers.

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

Yes. So I mean, you're right. The backlog is at unprecedented levels. And as how I see this year playing out, I can't give you a precise number here, I will say this. I think they'll remain elevated at kind of similar levels to where they are now. That would be my expectation as we kind of finish the second half of this year. And you also are correct in that the backlog should support our revenue for the next period of time even if gross demand orders are down. And in fact, this quarter is a good example of that, where we mentioned on the call that our orders were actually down single digits, but we not only delivered 10% product revenue growth, we also grew backlog \$250 million, right? So there's a fair amount of room there in orders. And that just gives us confidence in our ability to generate revenue for a sustainable future. And that's one reason why we raised our guidance to at least mid-single digits next year.

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

So the key point of the question was, can you, in fact, if you went through a stress test analysis like a bank, absorb 20% or 30% decline for 3 or 4 quarters and still end up with that massive backlog given where you are exiting '23. In which case, the only real question then is the improvement in the supply chains, your ability to deliver on better than 5% growth in the top line over that time frame so you clearly have the orders. And the

footnote to this, I just want to clarify, when you talk about the geographies in your print, that's a function of the timing of when orders came in. I assume these are first in, first out. and therefore, not reflective of any particular change in demand in any particular geography because it's -- your backlog increased. So therefore, I assume it's an allocation question, not a demand question.

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

Yes. So you're absolutely right. If you were to perform such a stress test, our model -- our revenue model, given the backlog we have, would still sustain at those types of declines in orders, those 20%, 30% decline. So your math is correct. And again, that gives us a lot of comfort in our revenue growth sustainability for the next couple of years here.

On the geo mix, I would say it is absolutely a factor of what we're able to ship, what supply we're able to procure. It's not quite as simple as first in, first out because, quite honestly, the supply chain is very dynamic, and we have shortages in some parts, and we have more parts available in others. So it's really about supply availability, and that really result in the revenue profile that you see really across the board, geographically as well as in some cases, the vertical cuts and the customer solution views is really about supply at this point. .

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**Operator**

The next question is coming from George Notter with Jefferies.

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

I guess I wanted to ask about some of the mix items affecting gross margins. You mentioned lower software license sales in the quarter. Can you be more specific about what that was? I realize it's lumpy. It was bigger in Q2, getting smaller in Q3 and Q4. But what precisely was that? And what drives that the cadence of revenue recognition there?

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

George, let me take a crack at it and then Ken, you can jump in. So total software grew 24% year-over-year. That's a good result, but it was down sequentially, and that affected our margins because of mix in the Q2 time frame. The software softness was really all in our perpetual offerings. And those can be lumpy. They can be -- they can swing around positively or negatively based on orders, state certain capabilities from some of the largest customers that we have for our routing and switching products.

Subscription software importantly remains really strong. And you can see that in deferred revenue. You can see that in our ARR, which grew at 34% year-over-year. So I'm actually really confident in our ability to achieve our long-term software projections as well as our ARR. And then Ken, you can talk a little bit more about the mix issues in Q2.

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

Yes. So as Rami mentioned, it really was a bit of a shortfall sequentially in our on-box and Junos-based perpetual licenses. These really are various features and functions of services that we provide within our Junos operating system. And there is some timing of rev rec that's difficult to predict here. Some of it is on customer buying behaviors, whether or not some customers might buy the lowest base level operating system software at time of purchase of an upgrade to maybe an advance or premium license later. There's also some true-ups between hardware and software that happens periodically. So the timing of this recognition, it's all perpetual software. It's all recognized immediately, but the timing could vary based on what they buy and when they choose to buy it. So that's really what we're seeing here.

Overall, our software business continues to perform quite well. I think we're ahead of the targets we set for ourselves 1.5 years ago at the Investor Day, both from an overall software perspective as well as our ARR target. So I feel very good about our software transformation and moving forward, I expect us to continue to have a very strong software story.

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

Got it. And then just as a follow-up. I know last quarter, I think more of the narrative around margins was on a higher mix of Mist access points, a lower mix of MX shipments, obviously, components drove that mix shift. But can you talk about how MX did this quarter, how you did with access points, did the mix of those pieces go up or down in Q2?

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

Yes. So MX actually went up. So our hardware mix on the routing side and the automated WAN side was up. That said, some of these perpetual software licenses that I was mentioning before actually were attributable to our automated WAN solutions. So the software mix within automated and WAN was down a bit, some of these perpetual licenses that we've talked about. But overall, the hardware mix was up. But it wasn't at the expense of access points. We continue to sell a lot of access points as well. You saw the results in AIDE up 17%. So really strength in both the MX/automated WAN business as well as our AIDE business. .

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**Operator**

The next question is coming from David Vogt with UBS.

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

So I have sort of 2 related questions on margins. So I think in the prepared remarks, you noted that supply chain going forward is getting a little bit better. So kind of against that backdrop, if supply chain is improving on the margin sort of quarter-over-quarter along with revenue that looks like it's going to be well above trend. Why are you not seeing more gross margin leverage in the third quarter despite the expedited fees, but it sounds like it's getting better? And if expedited fees are about 50% above your prior expectations, does that give you confidence and a line of sight into potentially 100 basis points of margin expansion next year, just basically effectively pushing it out by a year, what you had expected for this year as we entered the year?

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

Yes. So on the supply getting better, it's really kind of a nuanced message I want to make sure is well understood. Access to supply is still highly constrained. Lead times into us are still extremely limited. That said, we've taken some action to actually procure more supply. So I think we'll have more supply than we originally expected when we started the year, which is a good thing. So that's an improvement in supply, but it's coming at a cost, right? And that's really the offset here is that we are paying more of we're having to pay more expedite fees.

We're going to broker markets and paying several times more than we should be paying for that particular component in the open market. So it is coming at a cost. So volume is improving, but costs are going up is probably the short summary on the supply side. For 2023 on the supply, was it a supply related question as well?

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

Yes. I mean, Ken, I think you said expedited fees came in about 50% above your expectation. So that would translate into a little bit north of \$50 million or almost one point of margin. So how does that play into next year?

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

Yes. So I do believe those expedite fees and component costs, that \$155 million that I referenced, is transitory. And exactly the time frame it is difficult to predict. But I do believe if you go out, I don't know, a couple 2, 3 years, you'll see the majority, if not all, of those costs go away. However, the timing, how many -- the expedite fees we're paying, the elevated freight we're paying, it's hard to predict exactly when we're going to start to see that normalize. I do think we should see some benefit in 2023, but I'm not ready to quantify how much.

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**Operator**

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

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

I want to see if you could describe, I think, your backlog, what do you see happening in terms of the major product categories and your market share? I'm trying to get an understanding of where you're gaining market share based on your awards versus where you might be...

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

Simon?

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

Yes.

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

Sorry, we're going to interrupt you. Could you repeat the question? We had a glitch here. So we missed the part of your question, and sorry to bother you, but we're going to need you to repeat it.

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

No problem. You hear me okay now?

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

Yes, we can.

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

Okay. Great. I wanted to see if you could talk about within your pipeline, your backlog, how you see your market share trends in the major category. So what major verticals or products do you see yourself gaining share the most? And where do you see yourself most vulnerable in the mix. I know we've talked a lot about campus as an area where we've seen you gaining share. I want to see if you could talk a little bit more broadly about other product categories and just confirm the campus.

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

Yes, I'd be happy to. So I do think the one area where we are most obviously taking share is going to be in the enterprise and more specifically in the client to cloud. So that includes wired, wireless and increasingly, it's going to include a full stack solution of wired wireless and SD-WAN because we're now pretty much integrated our 128 Technology SD-WAN solution into that end-to-end AI-driven enterprise capability. So the numbers speak for themselves, double-digit revenue growth, double-digit order growth and all that. Very, very pleased there. .

I don't think that's the only place where we're taking share. I do think in terms of 400 gig opportunities, now that 400 gig has moved from discussions and PowerPoints into competitive bake-offs. I do think that we are winning share. Wherever there is a net new opportunity, be it for our service provider core, where I just talked in my prepared remarks about a new win, a new data center, cloud WAN opportunities. I do think and time will tell as this translates to actual revenue results and actual share results. I do think this is an area where we're performing very well, and we are taking share. The last area that I will mention that I think is going to be an obvious place where we're going to take share because we're really starting from very little is in the metro.

And 5G is a real thing. It's driving fiber buildouts by service providers. We are essentially very small players in the metro because we've never really had a complete portfolio, and we just announced that complete portfolio, and it should essentially come together and be fully in production by the early part of next year. So even in the absence of that solution, we're seeing 100-plus percent year-over-year growth in orders for ACX. I think that will only accelerate once we've got that complete solution.

I'm sure there are other areas where we're doing very well, data centers, for example, but those are the areas that I'd say are top of mind right now in terms of the biggest opportunity for share take.

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**Operator**

Next, we have Samik Chatterjee from JPMorgan.

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**Angela Jin** - JPMorgan Chase & Co, Research Division - Analyst

This is Angela Jin on for Samik. I know I hate to ask the recession question, but I was curious, how would each vertical respond in the event of a macro slowdown? And what are the areas of the portfolio that you think are more resilient to a slowdown versus more aligned to cyclical trends?

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

Thanks, Angela, for the question. I'll start. First, I think it's a hypothetical question because as I said, I think order strength remains very high. We don't see any obvious indicators that there is going to be macro headwinds. But of course, it's our job to stay very vigilant and to just make sure that we're looking for any early warning indicators. In terms of what one would expect would be with the challenging areas, service providers and cloud providers tend to have very strategic long-term projects.

And for that reason, I would expect that they would be more macro resilient. But even in the enterprise, where I would say that most people would expect that there might be the biggest risks if there were macro headwinds, there, what we have going for us, as I mentioned earlier, is we have massive TAMs, total addressable markets, \$30-plus billion across our client to cloud and data center. We're a relatively small player with small share, a very differentiated solution and plenty of room to grow even if there are, in fact, macro headwinds that affect that TAM. And I think part of the results we're posting are a little bit of a proof point for that.

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**Operator**

The next question is coming from Aaron Rakers with Wells Fargo.

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

I hate to do this, but I want to go back to the backlog a little bit. You mentioned in the prepared remarks, I know you disclosed it in the past that you had implemented some price increases back, I think you said in 2Q of '21. It sounds like you're going to implement some more actions here going forward. I'm just curious, considering the significant amount of backlog that's likely been built over the past year, let alone the \$500 million through the first half or \$550 million through the first half of the year. How do we think about those price actions starting to filter through that backlog and really starting to provide maybe the positive effect of the gross margin, understanding you've got a lot of supply chain dynamics going on?

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

Yes. So it is going to feather in over time. We are seeing more and more benefit each quarter. So Q2 this last quarter, we saw more benefit than we saw in Q1, and I expect us to see more benefit here in the second half from the pricing actions. The actions we're about ready to take really aren't going to start to play out until probably FY '23, given the backlog.

And again, I expect that to feather in overtime and be incremental over time as we move into the 2023 quarters. The unfortunate reality is the benefit we're seeing is getting more than offset by the cost, right? When we put the actions in place, we had some assumptions on the incremental cost, the expedite fees, freight costs, et cetera. And we undershot -- we overshot, I should say, or the cost to overshoot those expectations. So we are seeing some benefit. There is more of the pricing benefit in the backlog yet to come. That's going to continue to help us in the future quarters. But at this point, we just don't see that help enough to really keep the margin range where we started the year at 58% to 60%.

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

Yes. And just as a quick follow-up question. On the continued traction that you're seeing in 400 gig, I know this quarter, you had mentioned 80. I think last quarter, you mentioned 70 design wins. I'm curious if you were just asked like what inning do you think we're at in terms of kind of really volume deployments across those 80 design wins for 400 gig at this point? And when do you think actually, we're halfway through those deployments, just kind of thinking about the trajectory of those 400-gig wins.

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

Yes, it's a good question. First, I want to just clarify, the 80-or-so wins are data center 400-gig wins. We've actually -- we're now seeing close to a cumulative 400 wins across data center and wide area in service provider and in the cloud provider segments. In terms of where we are, I mean, if you look at port mix between 100 gig and 400 gig, both in terms of orders and shipments, it's still early innings for 400 gig. There are a lot more networks that are going to be built out with 400 gig. So we viewed -- these sorts of network interface inflections happen once every several years, maybe 4 or 5 years or so. We're now at the beginning stages of one of those inflections and that's good for our industry, certainly good for Juniper.

**Operator**

Next, we have Meta Marshall with Morgan Stanley.

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

Maybe following up on the answer to George's question. You mentioned kind of some uncertainty on what addition might be elected in terms of kind of where the perpetual revenue comes in for software. I was just trying to get a sense of some of that volatility or more pronounced this quarter just because of the amount of kind of cloud customers that you're servicing. Or just trying to get some insight into what is causing that volatility?



And then maybe just as a follow-up question. Just, is this kind of quarter where you would consider inventory peaking? Or do you still think that you'll be in an inventory kind of accumulation period for the kind of foreseeable future?

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

Yes. So on the software volatility, we did -- I mentioned buying patterns vary. And the reality is in Q4 of last year and Q1 of this year, we saw some of those above normal buying patterns where customers are either doing true-ups or maybe upgrading their software system from a base level to a more advanced or premium level. So we did see some of the kind of the high watermarks of that volatility in the past few quarters. In Q2, I think we saw a little bit more of a normal kind of hardware to software attach.

And at this point, I'm expecting the rest of the year to be largely similar to Q2. That said, customers could surprise me, want to upgrade their software stack here in the future, and we'll obviously be available for that if they decide to do that. So it's difficult to predict. I wouldn't call it out as any sort of customer pattern. It's really just more about timing of when they purchase perpetual software. And we had a couple of quarters of highs, and now I think we're back to kind of a normal from a perpetual perspective. As Rami mentioned, our subscription software, our SaaS software is growing well beyond normal, right? We continue to grow at extremely high levels on that part of our software portfolio.

From an inventory perspective, I don't think we've seen the end of the inventory build. We are still -- if you look at our open purchase orders, we are absolutely putting a demand signal out there that supports what we think is our demand opportunity, and that's going to result in more inventory. What's happening out there is we are definitely seeing constraints in certain parts but there's other parts of the bill of material that are not constrained. And that's really the part of the inventory that's building up. As we start to get some of the more critical parts, we'll be able to ship our backlog, and we'll see the inventory level start to go down. So I don't think inventory is going to start to decline until we start to see supply chains really improve and backlog levels start to come down.

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**Operator**

The next is coming from Sami Badri with Juniper (sic) [Credit Suisse].

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**Ahmed Sami Badri** - *Crédit Suisse AG, Research Division - Senior Analyst*

First question is if we were just to take the percentage of revenues in 2022 that reflects the price increase actions, what percentage of those revenues are coming through? And what is the objective of 2023? Will 2023 reflect all price action increases and maybe just like a percentage mix of 2022?

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

Yes. And I'm sorry, Sami, but that's not a level of detail I'm prepared to comment on, on this call. I'll say that I would expect it to normalize by, call it, 4 quarters out. So by late this year, we should see some normalization from the actions we took last year. But as far as the percentage of total revenue, I'm not prepared to comment on it at this call.

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**Operator**

Next, we have Tal Liani with Bank of America.

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

I want to go back to your 2023 guidance. I try to look at it multiple ways, and it looks to me either that you're banking -- or your assuming very steep decline in revenues in certain areas or that you're just very, very conservative. The -- in the 4 quarters of this year, your growing revenues,



the low is 8.3%, the highest is 13.5%. So there is substantial growth this year. And next year, we should see some of the backlog release being released. So 5% looks weak versus what we're seeing this year. And then also, if I just look at your enterprise growth. This year, substantial growth, it's about 35% of your revenues plus that alone contributes 4% of revenues, give or take, next year. So what are your assumptions? When you say 5% or better, the 5% mark, which I understand it's going to be better, what are your assumptions about the telecom market, about the cloud market when you project 5% or more? Are you assuming the end of projects? Are you assuming declines? Or what are basically your basic assumptions in saying 5%?

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

Let me start. I think the key here is that we didn't say it's 5%. We said it's at least 5% or at least mid-single digits. If, in fact, the markets play out as we expect, and there aren't any major sort of challenges macro-wise. Yes, the opportunity is absolutely there for us, not just to meet but to exceed that bar that we are setting for ourselves. It's just a little early right now. I don't think we typically provide color on the next year in this time frame. But we thought we'd start at this point in time. And yes, I mean I've talked quite a bit even on this call alone at about some of the catalysts around 5G, cloudification efforts, 400 gig, our enterprise. Yes, I mean I think these are all catalysts that can give us the opportunity to exceed that outlook.

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

And I would just comment, demand is not the primary driver of our revenue outlook for 2023. That -- given the backlog, given the strength we've seen and the momentum we have, all the things that Rami's mentioned, demand would definitely imply a higher level than mid -- at least mid-single digits. It's really a supply constrained view at this point. And the good news is we see the supply constraints being lessened. We expect volume to improve, which is why we thought giving you a number greater than what you had historically, which was at least low single digits was the prudent thing to do at this point.

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

Thank you, operator. That's all the questions we have. That concludes today's call.

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**Operator**

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.

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