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PRESENTATION

Operator

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

(Operator Instructions)

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

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

Thank you, operator. Good afternoon, and thank you, everyone, for joining us today. Here on the call today are Kevin Johnson, Chief Executive Officer; Robyn Denholm, Chief Financial Officer; and Bob Muglia, Executive Vice President, Software Solutions Division.

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



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

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

Please note that today's call is scheduled to last for one hour, and please limit your questions to one per firm. With that, I'll now turn the call over to Kevin.

Kevin Johnson - Juniper Networks Inc - CEO

Thanks, Kathleen and welcome, everyone. All major financial metrics this quarter were in line or ahead of our guided ranges, and we believe we executed well in what continues to be a challenging environment. The go-forward macro outlook is mixed, but we are focused on what's in our control. We are seeing momentum building in routing, and we see continued growth from our switching portfolio. We are also making good progress on our path to improving the performance of our security business. On the cost side, we are taking steps to reduce ongoing OpEx through a series of targeted efficiency programs over the next several quarters, and Robyn will take you through this in more detail. Finally, we continue to maintain a strong cash position, and we intend to execute against our previously-announced repurchase authorization of \$1 billion.

I'm going to focus my comments today on our key priorities in this near-term environment, and how we are executing against them. I'll provide a brief update on the traction we are seeing in the market, including with our new products, and I've asked Bob Muglia, who heads our Software Solutions Division to join the call to talk about developments in security and software. Robyn will also take you through our financial review and our outlook, and then we will take your questions.

Our second quarter showed some good performance in key areas with routing and switching driving results. We believe we are doing well in these markets, because we bring a portfolio of products and solutions that deliver outstanding value to our customers. Service providers, and increasingly, enterprises, are embracing networks that are flatter, that reduce complexity and cost, while also delivering greater performance to scale. We are helping customers drive more efficient OpEx, and greater productivity from their networks. The success of this approach we are taking with the customer can be seen in our expanding wireless footprint.

There are three to four areas we believe we are well positioned to continue to expand our position in wireless. One is our MX series, which provides customers with the single solution for convergence on the edge. Second is our SRX offering in security. We have built a strong footprint in helping large service providers secure mobile Internet traffic. And third, our new routing solutions, that support service providers as they drive efficiency by collapsing multiple networks in the core. Our PTX offering is off to a good start and we're deeply engaged with Verizon and others with this solution. Our ACX universal access router is also shipping this quarter, and is well-positioned for the backhaul infrastructure necessary to carry rapidly-increasing amounts of mobile traffic.

As we look out to the second half of the year, we continue to monitor the macroenvironment closely. We feel pretty good about the US Tier 1 service providers. Based on our level of engagement and conversations with them, we believe the data points suggest that we can anticipate a modest increase in second-half spend as compared to the first half. And as a result, the overall US market should continue to be an area of strength for us in the second half of the year. This is offset, however, by uncertainty in Europe, and slowing growth in some emerging markets.

On the enterprise side, our switching portfolio, along with QFabric, drove strong performance in the enterprise. I'm pleased to note that General Dynamics, a leading global systems integrator in the aerospace and defense industries, has deployed QFabric as part of its core network in two of its US datacenters. QFabric was chosen by General Dynamics for its ability to deliver scale, performance and flexibility, needed to deliver critical

applications in support of their mission. We have momentum in switching, and we believe we will continue to outgrow the market, despite the current mixed outlook for overall enterprise spending. We believe the public sector market will be challenging in light of the austerity measures in a number of countries, and budget constraints in the US.

In security, we are very focused on improving our market position. SRX remains a strong product for customers where scale matters, both at service providers and large enterprises. And as we talked about at the analyst meeting, we have a clear path to strengthen other elements of our portfolio. The new Security Designer offering is one example, and we like how the solution is coming together. Bob will fill you in more in a moment.

Looking out over the second half of the year, we are focused on execution near-term, while positioning the company to deliver on its long-term growth objectives. To that end, we have three clear near-term priorities. First, continue to drive momentum of our new products, with the right sales and marketing efforts. We are encouraged by our early progress, particularly with our routing and datacenter offerings. We set our revenue targets for new innovations at the analyst meeting, and we are very focused on those.

Second, we are aligning our resources with focus on the right projects and activities that drive performance now, and keep us on a path to deliver meaningful innovations to our customers. The priorities include revenue generation, customer satisfaction and the next wave of innovation at Juniper. Third, we are aligning our overall cost structure for efficiency and effectiveness. We are focused on driving operational excellence and productivity throughout the organization. We are committed to delivering against the long-term model we laid out at the analyst meeting. This includes ongoing initiatives across the Company in areas like supply chain, procurement, systems and processes, shared services and more. We are also taking steps with respect to our cost structure, and Robyn will take you through that in more detail shortly.

So to wrap up, we had a good second quarter. We believe we have executed well in a first half of 2012 that has remained challenging. We're delivering good performance relative to the market in routing and switching, and we are on a defined path to strengthen our products in security. Our new products are gaining traction in the market, and we will continue to ramp this year and next. As we look to the second half of the year, we are not planning for any improvement in the macroenvironment. To manage through this period, we've set clear priorities for how we run the business, with revenue generation, resource allocation and careful cost management all top-of-mind.

Thanks again for your time today, and I'll now turn the floor over to Bob Muglia. Bob?

Bob Muglia - Juniper Networks Inc - EVP - Software Solutions

Great. Thanks, Kevin. It's great to be on the call with everyone today.

Last month, at FAM, Stefan and I shared our view of the new network architecture; how we've aligned our two divisions around a domain-driven approach that syncs with our customers' view of their network, and how we're approaching the marketplace from both the R&D and go-to-market perspectives. Just to recap that briefly, our business is organized around two divisions, systems and software. Within the software division at Juniper, our philosophy is that software complements our systems, so our two divisions work closely together. In each division, we target three businesses, routing, switching and security. And for those businesses, we focus around the seven domains that comprise the major components of the network, whether we're talking to service providers or enterprise customers. This approach, two customer segments, three businesses, and seven domains, or 2-3-7, enables Juniper to conduct business-focused conversations with our customers, leveraging our unique understanding of networking technology and innovation to help them address their most pressing business challenges.

With that as a backdrop, what I would like to do with my time here today is zero in a little more on our strategy and progress in security, and how that relates to our broader activities in software development, as well as the riverbed relationship that we've announced earlier today. I'll start with security, as that has been a major area of focus for me since I arrived at Juniper last year. We continue to be pleased with our leadership position for the high-end SRX within the service provider community. In Q2, we saw good high-end SRX sales to SPs, based largely on the growth of LTE networks, and the benefits the SRX provides to this solution. We recognize that we have work to do to regain our momentum in enterprise security, but in Q2, we did see quarter-over-quarter and year-over-year growth in enterprise security for the first time in quite a while.



As we have commented recently, we are enhancing the features and capabilities of the SRX platform to meet the needs of all enterprises, from large customers through smaller deployments at the campus and branch level. In the short term, we are focused on management and the AppSecure portfolio, our application visibility and control solution. We are also building on our success in network security to deliver next-generation content security services, including building on our recent acquisition of Mykonos, thus enabling security intelligence across the entire security ecosystem, and transforming the customer experience.

Our focus on network management starts with Security Design, which we talked about at FAM. This is an application hosted on the Junos Space platform. The interface is designed from the ground up to handle the breadth that security management challenges, including next-gen firewall, POP firewall policy, IPS, network address translation policy, and perhaps most importantly, VPN management. We've had two releases of the product thus far, and security design is now deployed in production within a Tier 1 service provider. We've collected a considerable amount of customer feedback from enterprise accounts, to whom we've given early access to the technology, and we are quite pleased with their response. We have put a significant investment in terms of both R&D and customer engagement into developing security design, and we believe it provides us with very capable security management. Further releases later this year of Security Design will reflect the feedback we have received, and we expect to see deployments beginning in Q4, continuing through 2013.

Hopefully you saw our press announcement today regarding our technology relationship with Riverbed. I wanted to spend a few minutes on this, because it will also play into our broader software strategy, including security. This relationship recognizes the key role application acceleration plays, as the network and application layers begin to converge. Both Juniper and Riverbed are focused on delivering high performance, security and scale in this environment. As a part of the Riverbed relationship, we are pleased that Riverbed has selected Junos Pulse as the mobile client for the delivery of their industry-leading application acceleration solution.

A key part of the relationship is our licensing of Riverbed's Layer 7 application delivery controller technology. We plan to leverage this technology as a component in building out integrated solutions for scaling datacenter applications within the network. There will be multiple components to this integrated solution; existing Juniper systems and software capabilities; licensed technologies such as Riverbed's; and new technologies that we are developing internally over time.

The relationship with Riverbed is an important one as we think about our overall strategy for software within the context of market trends. We start with the premise that software is core to our innovation strategy. It complements our systems. Today, we have licensed strategic technology for application delivery that complements our existing platform and software assets. This is important for the long term. The Juniper products that we will build, using the application delivery controller technology, won't ship for some time. Yet it's clear, with the evolution of the new network, that software such as this will play a bigger and bigger role across the routing, switching, and security businesses we serve. We're making foundational investments today that position us well, as the new network becomes more software-defined.

In summary, this is an important time for the industry and for Juniper, and software programmability will be key to the new network, and of which software will play a major role. We have a history in this space, and we're investing today in building on our strengths, both organically and via acquisitions of key technology. We approach this opportunity the way we always approach innovation, with a strong focus on understanding the customer and their needs. Security plays a major role in these efforts and our business overall. While we have been clear about some of the challenges we have had in the enterprise, we have made substantive progress and are positioned well for the future.

We know where we need to be, and how to get there. Security is a dynamic market and it is changing rapidly, driven in particular by the impact of mobility. That creates the opportunity for us to grow in this market. With the strength of the SRX platform and the innovation underway with security design, we're well-positioned and focused on executing our plan.

Thanks for your time, and I'll turn it now over to Robyn.

Robyn Denholm - Juniper Networks Inc - EVP and CFO

Thank you, Bob, and good afternoon, everyone. Juniper's results in the second quarter were slightly higher than our guided ranges, and reflected better operational performance. We remain focused on executing our strategy to drive revenue growth and disciplined operational execution. We

believe the long-term demand fundamentals for high performance networking are solid, yet the near-term environment continues to be uncertain, and many customers remain cautious. Looking at our demand metrics for the quarter, book-to-bill was greater than one, and product deferred revenue and product backlog increased sequentially. We saw good customer demand for our new products, including the PTX, T4000, and QFabric.

Total revenue was \$1.074 billion; a 4% sequential increase, and a decline of 4% year-over-year. As anticipated, the sequential increase was due to good enterprise and service provider growth in the Americas, which offset weakness in the other regions. The year-over-year decline was mainly due to service provider weakness in EMEA and in APAC. In the second quarter, Verizon accounted for approximately 12% of Juniper's total revenue. This was driven by demand for our routers, switches, security solutions, and services across Verizon's wired and wireless networks. It also reflects initial revenue from their recently-announced deployment of PTX.

For the second quarter, GAAP diluted earnings per share were \$0.11. This includes a \$0.02 gain from equity investments. Non-GAAP diluted earnings per share were \$0.19; up \$0.03 sequentially, and down \$0.12 year-over-year. The sequential increase was due to improved revenue and margins.

Now, let me provide some color on revenue by region, business segment and market. In the second quarter, the Americas were approximately 55% of total revenue, EMEA 28%, and APAC 17%. Americas' revenue was up 11% sequentially, and 1% year-over-year. The sequential increase was due to broad-based enterprise strength, with the exception of federal and financial services. In service provider, we saw higher revenue from cable, content and some wireless and wireline customers. On a year-over-year basis, the growth was driven by service provider.

EMEA revenue was down 3% sequentially and 9% year-over-year, reflecting ongoing weakness in service providers. We see customers in EMEA continuing to take a cautious stance with their CapEx in response to the uncertain macroenvironment. APAC revenue was down 4% sequentially, and 12% year-over-year. In service provider, APAC, excluding Japan, was up 10% sequentially. We continue to capture design wins with service providers in the region. Year-over-year, most of the region declined as a result of lower service provider demand.

Now let me review our revenue by segment. Platform Systems Division revenue was \$872 million; up 6% sequentially and down 5% year-over-year. PSD router product revenue was \$488 million; up 7% sequentially, and down 16% year-over-year. We had sequential increases in both Edge and Core routing. Year-over-year, we saw a modest increase in Core routing, which was more than offset by a decline in Edge routing. Total router product revenue, including both PSD and SSD increased 6% from Q1 to \$506 million. We saw good sequential increase in revenue from both P4000 and PTX.

Total Switching product revenue increased 13% to \$140 million. We are pleased with the momentum of EX, QFabric and wireless LAN, which all grew sequentially and year-over-year. SSD revenue in the second quarter was \$202 million; down 3% sequentially and 1% year-over-year. Total security product revenue was \$159 million; down 6% sequentially and flat year-over-year. The sequential decline was a result of slower demand in service provider and growth in enterprise.

As expected, high-end SRX product revenue declined sequentially and grew year-over-year, as customer deployment timing continues to drive fluctuations in service provider revenues for this product. In the quarter, we did see a good sequential increase in enterprise. We continue to see good customer traction with recent design wins with financial services and Internet firms. Branch SRX, which is reported as part of PSD, was up both sequentially and year-over-year.

Looking more closely at the markets we address, service provider revenue was \$681 million; down 1% sequentially. Revenue was down 7% on a year-over-year basis, as weakness in APAC and EMEA offset strength in the Americas. Enterprise revenue was \$393 million, up 13% sequentially, and flat year-over-year. On a year-over-year basis, growth in EMEA and APAC offset a moderate decline in the Americas. For the quarter, service provider was 64% of total revenue, and enterprise was 36% of total revenue.

Moving on to gross margins and operating expenses. Non-GAAP gross margins for the second quarter increased to 63.4%, compared to 62.6% last quarter. Non-GAAP product gross margins were flat with the first quarter. A favorable routing mix was offset by a higher switching mix, and some cost increases in security. Non-GAAP services gross margins were 59.4%, up 2.6 points from the prior quarter. This was the result of higher revenues, due to service contract renewals and lower costs. Non-GAAP operating expenses decreased sequentially to \$520 million. Looking at headcount,

we ended the quarter with 9,373 employees, a sequential increase of 155, as we continue to hire in sales and service with the goal of driving revenue growth.

Non-GAAP operating margin for the quarter was 15%. This sequential increase of 3 points was due to higher revenue and improved gross margins and slightly lower operating expenses. Looking at segment contribution margins, PSD contribution margin was 40.3% of revenue, up sequentially on improved revenue and gross margins. For SSD, contribution margin was 36.8% of revenues, which is slightly lower sequentially, due to decreased revenue, and margins, partially offset by reduced operating expenses. The GAAP tax rate was 35.5% for the quarter. The non-GAAP tax rate was 30.7%, 4.9 points above the prior quarter, due primarily to the geographic mix of income. As a reminder, the tax break reflects the expiration of the R&D tax credit.

Looking at the balance sheet, we ended the quarter with \$3.3 billion of net cash and investments. Cash flow from operations was \$212 million. Cash flow was up sequentially, reflecting higher earnings and good working capital performance. DSO was 34 days in the quarter, down from 39 days last quarter, and in the second quarter of last year. Capital expenditures and depreciation were up slightly from the prior quarter, as we continue to build out our Sunnyvale campus. We repurchased approximately 5 million shares for \$94 million, an increase over the prior two quarters.

Now, I will review our outlook for the third quarter, and as a reminder, these metrics are provided on a non-GAAP basis, except for revenue and share count. Looking ahead, we expect customers to remain cautious. We anticipate ongoing weakness in EMEA through the balance of the year, and that enterprise markets globally will continue to invest carefully. We are making good progress on our new product introductions, and we remain focused on driving revenue growth and disciplined operational execution.

For the third quarter, we expect revenues to range from \$1.040 billion to \$1.075 million. Gross margins are expected to be roughly flat sequentially, at the high end of the revenue range. Operating expenses are expected to increase by approximately \$10 million, due to annual employee merit increases. We expect operating margins to range from 13% to 14%. This is expected to result in non-GAAP diluted EPS of between \$0.15 and \$0.18 per share, assuming a flat share count, a tax rate of 31% and no renewal of the R&D tax credit.

Before we go to Q&A, I'd also like to update you on two topics we discussed at our financial analyst meeting in June. First, we recently announced a \$1 billion increase in our share repurchase authorization. Given the current market, we intend to be more opportunistic in the near term. Obviously, we will calibrate our buybacks in future quarters with market conditions at the time, but based on current trends, we clearly recognize the opportunity to do more.

The second update is around our productivity and efficiency initiatives. As I outlined at FAM, actions are currently underway that will reduce ongoing operating expenses. In 2013, we anticipate an operating expense reduction of approximately \$150 million of our estimated 2012 levels, with benefits beginning to be reflected in Q1, and the majority of the reduction occurring in the second half of 2013.

In summary, given our view of the challenging near-term market conditions, we will continue to execute with agility and flexibility while balancing the long term needs of the business to deliver innovation and revenue growth. I would like to thank our dedicated employees for their hard work and commitment. They continue to be key to our success in delivering the new network.

And now, I will hand it over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Ehud Gelblum with Morgan Stanley Smith Barney. Please proceed with your question



Ehud Gelblum - Morgan Stanley - Analyst

I just have a couple. Kevin, just a clarification, when you were talking about wireless, a lot of opportunities you're getting in wireless, you didn't mention MobileNext, so I was wondering if that was kind of a slip-up or intentionally that wasn't really -- maybe there's a de-emphasis on MobileNext, so maybe that was just a clarification. Robyn, you're talking about the gross margin mix. You said that routing was a positive driver of gross margin, but it was offset by a negative gross margin mix in switching. I'm wondering, is that negative gross margin mix in switching -- that's hard to say -- due to the entry of QFabric into the switching mix, and if so, can you give us a sense as to how large QFabric was, and what you expect that to be in the next quarter and going forward, and give us a sense as to how that grows and if it does impact gross margin like that?

Kevin Johnson - Juniper Networks Inc - CEO

Thanks for your questions, Ehud. I'll take the first question on MobileNext. Certainly MobileNext, we've made a lot of progress on MobileNext from a feature capability standpoint, and the key enabler that MobileNext drives for us, it gets the MX. It's one of the services that can run on the MX to make the MX an established footprint on the edge of the network in the wireless side, and we've seen a lot of the adoption of the MX as it's engaged with customers on the wireless side in addition to the wireline side.

MobileNext, we continue to build out new sets of features. I'll let Bob talk a little bit about the new feature capabilities. We're making slow but steady progress on MobileNext, but the key for MobileNext is to establish the MX as a footprint in the wireless, and we're pleased with the progress we're seeing in the MX, and we continue to focus on the work that we're doing with MobileNext. Bob, you want to comment just briefly?

Bob Muglia - Juniper Networks Inc - EVP - Software Solutions

We've shipped the EPC capabilities and GGSN capabilities of MobileNext, and that is in production right now, and running well at Elisa, and we are getting feedback from our customers that there are a set of additional features that they're interested in seeing from us, consistent with what was said at FAM, these include things like the enforcement capabilities and DPI capabilities. All of these things, EPC, DPI, the PCEF enforcement capabilities are all part of the universal edge of the set of broad services that run on our MX platform. The unique thing about that is that it provides these broad services for both wireline and wireless customers.

Robyn Denholm - Juniper Networks Inc - EVP and CFO

So, Ehud in, terms of the mix comment on the call, yes, router mix was favorable in the quarter. The other thing I mentioned on this call was that it was offset by a few costs on the security side to do with our deployments of some recent wins in terms of the security side. So that's what I mentioned, that was offsetting the favorable mix on the router side.

Ehud Gelblum - Morgan Stanley - Analyst

I'm actually talking about QFabric. Can you give us a sense as to how large that was, and if that impacted gross margin at all on the negative side?

Robyn Denholm - Juniper Networks Inc - EVP and CFO

Yes. In terms of QFabric, we were pleased with the performance of all three lines of business in the switching area, both EX, QFabric and wireless LAN were all up sequentially and year over year, and in terms of gross margin, that was a -- no impact on the gross margin average.

Ehud Gelblum - Morgan Stanley - Analyst

Okay, great. I appreciate it. Thank you.



Operator

Our next question comes from the line of Simona Jankowski with Goldman Sachs. Please proceed with your question.

Simona Jankowski - Goldman Sachs - Analyst

Routing was better than expected in the quarter, even though you highlighted some of the weakness in EMEA as a service provider, and also when Verizon was down sequentially. So can you just give us a bit more detail on what drove the upside there, and also just as an update on the T4000, which I know you highlighted, the revenues in that product, are they still tied through qualification or are we seeing actual deployments, and if not, then when do you think we'll see the deployment revenue for that product?

Kevin Johnson - Juniper Networks Inc - CEO

Thanks for the question, Simona. I'll take the second question and let Robyn comment on the overall router revenues per expectation. The T4000 is, as we come out with that product, keep in mind it's a seamless upgrade to the existing T series chassis, and what we see customers doing now, we have a number of customers who have purchased and implemented the chassis upgrade kit that allows those chassis now to be provisioned to be able to accept both the older T series line cards as well as the T4000 line cards. And then, consistent with the way service providers go, a number of them are going through certification testing and that process, but I think we're pleased with the level of engagement that we've gotten both with PTX and T4000 in the core, and we're going to continue to stay focused as we work with customers through the certification process, and then certainly as they do line card upgrades. That presents more opportunity for us.

Robyn Denholm - Juniper Networks Inc - EVP and CFO

Yes. And in terms of the overall mix of routing, both core and edge were up quarter-over-quarter. Core was also up year-over-year, which is obviously a favorable trend for the quarter. So we were pleased with the routing mix in the quarter.

Simona Jankowski - Goldman Sachs - Analyst

But just as far as a little bit of additional detail, could you just highlight the source of that sequential increase, because by process of elimination, it sounds like it was not EMEA, and it was not Verizon, so if you can just highlight a bit more of any incremental new wins or upgrades, or what might be happening with your other customers?

Kevin Johnson - Juniper Networks Inc - CEO

I think I might. I'd say clearly it was more US-driven, offset by some of the weakness in Europe, and certainly within the US, our Tier 1 service provider business performed well. In addition to that, though, if you look at certain sectors of the US like the cable customers that we engage with, cable did well. As you know, that was also a strong performance in US cable providers, and it's consistent with the value proposition and the messaging that we have overall in routing, but I'd say that was mainly driven by strength in the US, a combination of Tier 1s as well as our cable segment, and offset a little bit by some of the weakness in Europe.

Simona Jankowski - Goldman Sachs - Analyst

Thank you.

Operator

Our next question comes from the line of Rod Hall with JPMorgan. Please proceed with your question.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Just one clarification for Robyn, and then a question, clarification is on the gross margins and services. Robyn, you said that one of the drivers for the better margins were costs. I just wondered if you could elaborate on that a little bit in terms of what you have changed with respect to costs there that helped the gross margins? And then the question is on the Riverbed deal. I think I heard you say that it would be some time before you'd ship products that would incorporate that Riverbed ADC software, which makes sense. I just wonder if, in the meantime, there's any opportunity to do joint deals or any kind of partnership out in the channel to serve customer needs. Thanks.

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

Yes. I'll talk about the gross margin. Then I'll hand it over to Bob. So in terms of services, gross margin was a good sequential increase in terms of gross margin for services, driven by revenue growth quarter-over-- quarter, and also by cost, as you mentioned, Rod. So on the cost side, we've been talking about increased costs in the services space for a while, due to architectural personnel and increased services capability to do with our new product introductions. So clearly, good cost management on an ongoing basis by the team in services also helped this quarter with our gross margins.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Robyn, did you actually hold costs stable while revenues grew? Is that more what happened, or did you actually reduce costs?

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

We did reduce costs a little bit, but also revenues increased in the quarter. So it's a combination of both. I talked about both on the call.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Okay.

Bob Muglia - *Juniper Networks Inc - EVP - Software Solutions*

So in the context of the Riverbed relationship there are really two parts to the relationship. One part is working with riverbed to incorporate their application acceleration technology into the Pulse mobile client, and we will not really be able to do a lot of go-to-market work with them in that space until that technology is integrated in, but that is on its own schedule and we'll work with them to get ship dates at a later time. The second piece is really the ADC technology that we licensed from them, and we would anticipate that technology being built into Juniper products, and being delivered to the market as a Juniper set of products. So there's no plans to resell the Riverbed technology in that space.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Bob, what I was wondering, it sounds like that ADC will take a while to build into products. It's not going to happen overnight, but I assume that's driven by a customer need. Customers are wanting some ADC integration. There's no opportunity to work with them to do joint solutions for customers or something like that?

Bob Muglia - Juniper Networks Inc - EVP - Software Solutions

Well, there's always opportunity. There's nothing specific to announce at this time on that, but we definitely see that this technology is very interesting. We see it as an opportunity for software to add value on top of the systems that we build. It is particularly interesting in the datacenter space. This is one of the good examples of software services that are very complementary. We also see long-term that technology is beneficial in other domains such as the Edge and the service provider space.

Rod Hall - JPMorgan Securities Inc. - Analyst

Great. Okay, thank you.

Operator

Our next question comes from the line of Brian Marshall with the ISI Group. Please proceed with your question.

Brian Marshall - ISI Group - Analyst

Question, with respect to gross margins and the follow-up on that financial model. If you look at it, your revenues were up about 4% sequential in the quarter, but your gross margins were up, almost roughly 100 basis points sequentially. So I think that would imply that you have an increasing richness of the revenue mix, as not all that improvement came from increased volumes. So I guess I'd love to hear the puts and takes there. And then also, how that transitions with respect to the September quarter, because I would expect that the new products would be ramping faster than the older products, and some of them carry obviously higher gross margins associated with them, and so at the high end of the revenue guidance implies flat gross margins. I guess I would expect they would be actually a little bit higher than that, so would love some commentary there. And then the follow-up would be, can you talk a little bit about that \$0.02 dilution hit as well? I apologize, I missed the prepared remarks. Thank you.

Robyn Denholm - Juniper Networks Inc - EVP and CFO

So in terms of the mix in the quarter affecting gross margin, yes, routing mix was up in the quarter, and I mentioned in my prepared remarks that Core was up both quarter-over-quarter and year-over-year, and as we have discussed, that does have a favorable impact in terms of gross margins. So we're pleased with the gross margin performance in the quarter and do see that at the high end guidance, continuing into the third quarter. In terms of the \$0.02, we talked about a \$0.02 favorable impact to the operating income due to a gain on investments. I think that was the question. Was that the question, Brian?

Brian Marshall - ISI Group - Analyst

Yes. I guess the follow-up on the September gross margins. I mean all things else being equal, if you're flat sequentially on the revenue side, I would anticipate that you have an increasing richness of the mix and some margins would be up. So I guess, can you talk a little bit about what the offsets are that would be pulling that down, if that would be the case? Thanks.

Robyn Denholm - Juniper Networks Inc - EVP and CFO

Yes. In terms of guidance for the third quarter, in terms of the trends that we see, we obviously see a continuing weakness in EMEA in service provider, through the end of the year. Kevin mentioned that and so did I. We also see continued positive momentum with the US service providers, and obviously we also see some opportunities to increase revenue in terms of enterprise. So in terms of mix, we're really calling up to be roughly flat going forward between service provider and enterprise growth there.



Brian Marshall - *ISI Group - Analyst*

Thank you.

Operator

Our next question comes from the line of Mark Sue with RBC Capital Markets. Please proceed with your question.

Mark Sue - *RBC Capital Markets - Analyst*

Thank you. Just a clarification. The Riverbed, on the ADC side, does that mean your Radware partnership ends? And the question is with the assumption of a better second half, what sort of seasonality should we expect later in the year? Should we think similar sequential growth levels from last year, or should we think of normal teen sequential growth rates? I asked since US service providers are improving, but the environment is still tough, and the European carriers, it's been so long since they've upgraded their networks. It seems like they are due for a big upgrade. So, I'm just trying to get a sense of how you feel about how we finish the balance of the year.

Bob Muglia - *Juniper Networks Inc - EVP - Software Solutions*

I think the regular question first. No, it does not mean that our Radware partnership ends. In fact, we continue to work closely with Radware on delivery of their technology, on top of the MX platform to a variety of customers, particularly focused on the service provider edge, and we'll be pleased even after we have product in the market that does ADC technology on our own, we'll be pleased to continue to work with Riverbed to service customers that want to use their technology.

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes. Mark, I'll take the second part of your question on seasonality. What we see with US Tier 1 service providers, seasonality of first half versus second half is returning to the more expected pattern that we saw, with the exception of last year. We think second-half spending by the Tier 1 service providers in the US will be higher than first half. If you just look at their guided CapEx, something like 46% in the first half, 54% in the second half is what you look at, but if you just take the Tier 1 service providers, they only represent about 25% of the total CapEx globally, and I think the uptick in US is offset by the weakness that we see in Europe and other parts of Asia-Pacific. So, the net is that we're taking a cautious position given the macroenvironment in Europe, and continue to play to our strength with our business in the US.

Mark Sue - *RBC Capital Markets - Analyst*

Kevin, just a quick thought. A lot of the networks in Europe seem to be running above service level agreements, which implies that they have to upgrade. What's their feedback, or is it just still there, the macro for them, their balance sheets or their CapEx, and do you think they get to a point where they have to upgrade?

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes. It's a good question, Mark, and we've seen this pattern before. The long-term demands, fundamentals of growth in network traffic continue. There's more devices. There's more video. There's more users. There's more datacenters. There's just more traffic.

So as traffic continues to grow, and if there's a slowdown or pause in some of the capital expenditures for routing in the service provider sector, certainly that implies that customers are running their networks hotter, and that would be consistent with our view and our engagement with customers. Question will be, at what point do they either hit the point where they're running so hot that they need to make the investments, or at

what point do the economic conditions for those customers hit a situation where they start to do upgrades, and build more capacity in their networks?

But the important point I think is the long term demand fundamentals remain intact. Traffic continues to grow, and every customer situation is different. In certain cases, it may be a function of their revenue. In some cases, it's a function of their balance sheet. In some cases, they're being cautious given the economic situation in the country that they reside. But what we're doing is, we're being very focused and very connected with those customers to ensure that we're working proactively with them, so that when they do start to spend and upgrade and launch new projects, that Juniper is there with a great value proposition and prepared to help them do that.

Mark Sue - *RBC Capital Markets - Analyst*

Okay. Thank you. Good luck.

Operator

Our next question comes from the line of Jeff Kvaal with Barclays Capital. Please proceed with your question.

Jeff Kvaal - *Barclays Capital - Analyst*

Robyn, a question for you on the OpEx. The numbers that you're providing are for full year comparison from 2012 to 2013, and the second part of that is, why would it take so long for the reductions to filter into the financials? Thanks.

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

Yes. So in terms of what I talked about in the prepared remarks, the \$150 million reduction in OpEx for 2013 is the full year over full year impact. What we're expecting to see is that impact really start to come in, in Q1 of next year and increase over the full year, and so as I said in my prepared remarks, the second half of the year is where we see the majority of the reduction happening.

Jeff Kvaal - *Barclays Capital - Analyst*

Why not get started on that process a little sooner? And furthermore, are there specific areas that we should be watching for the reductions?

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

Yes. As I outlined in FAM, we're working on productivity and efficiency initiatives across the company. So it's quite surgical. There are things that we're actually targeting in terms of sort of long-standing cost reduction activity, rather than just one set of things in one area. It's across the board whether it's streamlining things in the back office function as well as in the R&D area as well as in sales and marketing as well.

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes. I'd just add, Jeff, we're not waiting for some of that. We're working on this and we will get the cost structure in place as soon as practical. We're trying to be very thoughtful about how we do that so that we maintain a focus on the priorities we have, which are driving the revenue, top line revenue, continue to drive the wave of innovation. But gaining these efficiencies, a lot of what Robyn described is through efficiency gains, which has to do with process change and underlying systems that get aligned with them, but we aren't waiting. We're moving, and we will get these as soon as practical.



Jeff Kvaal - *Barclays Capital - Analyst*

Okay. Kevin, could I just ask you observations on VMWare's move into this space with Nicera what are your take-aways from that deal? Thank you.

Kevin Johnson - *Juniper Networks Inc - CEO*

Thanks for your question, Jeff. I think at the analyst meeting in early June, Pradeep, Stefan, and Bob, I think, shared our view of software defined networks and our focus on this. We certainly are aligned with the goals and where software-defined networks are going. I think at the analyst meeting, we outlined that three years ago with our launch of the concept of the new network. We certainly have been very engaged with the industry and the community as it relates to software-defined networks and we will continue to say very engaged in it.

I think if you look at the comments that Pradeep made, we're going to continue to be very thoughtful and balanced in terms of what we're doing on the R&D agenda to make sure that we're delivering the best possible solutions to our customers, and certainly, the work that we're doing in our switching and fabric business, as it relates to datacenters is very applicable and very relevant to Nicera and very applicable and relevant to what VMWare is doing, and that's that. We're going to continue to focus on how we can innovate and deliver the best possible solutions to customers in a world of software-defined networks.

Operator

Our next question comes from the line of George Notter with Jefferies. Please proceed with your question.

George Notter - *Jefferies & Company - Analyst*

Just expanding on that thought, I guess I'm wondering when Juniper might be able to deliver a product in the SDN area. Is there a set of timelines or dates that you have in mind? And also on QFabric, I was just hoping to get an update on customer count there, and any more comments or tangible data points you have on traction with QFabric would be helpful. Thanks.

Bob Muglia - *Juniper Networks Inc - EVP - Software Solutions*

Let me take the first question of when we'll be delivering products in the SDN space. We already have today a number of products that have many attributes of SDN and I'll first point out that when the industry talks about SDN, there's a great deal of similarity to the programmable network which we've been talking about for several years. SDN is really all about how applications and the infrastructure that support them can drive the network, and get the network to do what it wants, and that's really precisely the same goal we outlined several years ago when we talked about the programmable network.

So the work we've done to date in building the Junos SDK is really industry leading work that is completely consistent with SDN. In specific areas of SDN, things like OpenFlow, we have today some open source capabilities for people to build on top of our platforms, and we're in the process of building production-capable OpenFlow technology across a wide variety of Juniper products going into 2013. So what I would say is we have products today, and we're going to continue to enhance and expand those products, and we'll work very closely across the industry, including with partners like VMWare, to ensure that Juniper Networks, the platforms and the software that we provide is the best complement to the software that they deliver.

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes. I'll give you sort of the quick update on QFabric. I think at the end of our last quarter call, we had mentioned that we had 150 customers running QFabric nodes. In this quarter, in second quarter, we surpassed the 200 customer mark running QFabric nodes. So we continue to see very good

uptick of customers running QFabric nodes, and certainly we're seeing a growing number of those customers also now purchase, and either go through certification or deployment of the full QFabric systems. We announced the new interconnect system called the QFX3000-M, and this is important and a relevant point, because it is a fixed interconnect that provides QFabric for up to 16 nodes, and so it provides a lower entry point for those customers who have purchased and deployed nodes who now want to try the full QFabric system. They can deploy the QFX3000-M, and it lowers the entry point and provides them flexibility in terms of how they want to deploy that in a fixed interconnect node. We've surpassed 200 customers in the quarter, continue to see good progress on the QFX3500 with the top of rack in the nodes, and certainly a subset of those customers have purchase and continue to deploy the full QFabric system.

Operator

Our next question comes from the line of Paul Silverstein with Credit Suisse. Please proceed with your question.

Paul Silverstein - Credit Suisse - Analyst

A couple quick ones. First off, Kevin or Robyn, can you comment on the linearity in the quarter as well as close rates? Secondly, with respect to AppDelivery and optimization, I'm curious. Kevin, have you gone back and looked at what's different this time around, relative to back in 2005 when you purchased Red Line and Peribit, which if I remember correctly, Peribit was a leader at the time and went off. Red Line was a pretty decent private company as well. What's different about this initiative relative to that last go round in terms of driving revenue and bottom line? And, finally, Bob, I'm curious, the \$150 million number for the OpEx savings for next year, it doesn't sound like you have a staff reduction target, that this isn't coming from headcount reduction. Maybe I misunderstood. If that's the case, how do you come up with \$150 million?

Robyn Denholm - Juniper Networks Inc - EVP and CFO

Paul, let me tackle the first question and the last one. In terms of linearity, nothing unusual to comment on in terms of linearity for the quarter. You can see with the DSO that we had that it was a relatively linear quarter, so nothing unusual to comment there. In terms of the cost reductions, let me start by saying, our strategy is around driving revenue growth. We talked about that at the Analyst Day. We're very focused on doing that. We're also focused on driving operational execution across the board, whether it is to drive that revenue growth or reduce our percentage of OpEx to revenue, and as I outlined at FAM, we are targeted at 39% to 42% of revenue as our OpEx over the next three years. What I've announced today is that we've now -- at FAM, I talked about we had identified opportunities in that range. Now we've identified those cost savings, and we're in the process of implementing those as we speak. So we'll talk more about those as we start to show the amounts in the P&L, but we're very focused on delivering both, both revenue growth and operating expense efficiency.

Bob Muglia - Juniper Networks Inc - EVP - Software Solutions

With regards to the question about the previous acquisitions that Juniper did quite some time ago relative to the work that we'll be doing around, particularly the ADC space, I can't say too much about what happened a long time ago. I certainly wasn't here then, but I will say that today, as we sit here, we have a great deal of clarity across the two customer segments that we're targeting, the service provider and the enterprise, the three businesses we're in, switching, security and routing, and then the seven domains, and in particular with the domains, it provides us a deep context of understanding of customers' business needs, and we see this technology as being critical to fulfill those needs, and that's why we've created the relationship that we have, and we think it's a good, sound financial decision, and we think it's a good business opportunity for us going forward.

Kevin Johnson - Juniper Networks Inc - CEO

Yes, Paul, this is Kevin. I'll just add to Bob's comments. I think we are in the switching fabric business in the datacenter today. We were not back then, and so there's clearly in our opinion, a technology synergy related to the ADC and the systems. The fact that we built Layer 2, Layer 3 load balancing into our underlying systems and then complement that now with Layer 7 ADC in systems like MXs, SRX and QFabric allows to us bring



this technology in the form of a line card that now is tightly integrated into the system. So I think that's a fundamental difference in both footprint, technology capabilities and synergies in term of how we go to market.

Operator

Our next question comes from the line of Tal Liani with Banc of America Merrill Lynch. Please proceed with your question.

Tal Liani - BofA Merrill Lynch - Analyst

Hi, hope you can hear me. I have two questions. First is on the security part. Bob, you spoke about great investments in security, but revenues this quarter were down 6% sequentially. How do you, or when do you see the new efforts contributing to revenues, and how do you see the rest of the year playing out in security? How are you -- if you can repeat a little bit, I think you highlighted, how are you going to innovate, differentiate versus competition?

The second question is clarification about what you said on ADC. I don't understand why you're going to have two different pieces of software, one from Radware, one from Riverbed and invest in both and try to integrate and try to educate the salespeople on both and how does this work with your desire to lower costs? So where is the rationale in keeping both? Thanks.

Kevin Johnson - Juniper Networks Inc - CEO

The first one with regards to security in terms of the quarter-to-quarter overall decline, what you're seeing there is the somewhat cyclic nature of service provider buying. As we mentioned, we saw growth both quarter-to-quarter and year-over-year in enterprise, which tends to have a more consistent curve attached to it. In terms of when -- the time frames for when we see ourselves being able to have more consistent growth, we will see. As the new products and technologies come out later this year and we see customer adoption, we do feel that going into 2013, our security business will be seeing some very consistent recovery, and we've made a wide variety of steps within the security business to really address the challenges we have, including putting effectively an entirely new management team in place, which is well established now and is now executing very effectively on the initiatives in front of them. So I feel good about the steps that have been taken, and the progress that we're making. I feel good about the feedback that we're seeing from customers, and where we're headed with that business.

With regards to the question about ADC and the two different packages, recognize that our relationship with Radware is one where, they do development on top of the SDK that we provide, and then we work together to deliver our solutions to particular customers. We do that quite a bit with a wide variety of different partners in the industry, and it's actually in our benefit to have an open ecosystem, to allow others to build on top of our platforms. And so it makes sense for to us continue to do that. In terms of our R&D investment, it will be focused on the Riverbed technology. That's where we'll be putting our own investment and in terms of bringing Juniper-based products to market, it will be based on that technology, but as I mentioned, that is still some time away. It's still a little while before we'll have the product to the market.

Tal Liani - BofA Merrill Lynch - Analyst

Thank you.

Kathleen Nemeth - Juniper Networks Inc - VP - IR

Thank you. That is all the time we have today. We appreciate your attending today's call and we look forward to speaking with you again next quarter.



Operator

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

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