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JNPR - Q1 2013 Juniper Networks Preliminary Earnings Conference Call

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CORPORATE PARTICIPANTS

Kathleen Nemeth *Juniper Networks Inc - VP IR*

Kevin Johnson *Juniper Networks Inc - CEO*

Rami Rahim *Juniper Networks Inc - EVP, Platform Systems Division*

Robyn Denholm *Juniper Networks Inc - CFO*

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

CONFERENCE CALL PARTICIPANTS

Rod Hall *JPMorgan Securities Inc. - Analyst*

Kevin Dennean *Citigroup - Analyst*

Mark McKechnie *Evercore Partners - Analyst*

Amitabh Passi *UBS - Analyst*

Stephen Patel *ISI Group - Analyst*

Tal Liani *BofA Merrill Lynch - Analyst*

George Notter *Jefferies & Company - Analyst*

Ehud Gelblum *Morgan Stanley - Analyst*

Subu Subrahmanyan *The Juda Group - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the Juniper Networks first-quarter 2013 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, Ms. Kathleen Nemeth, Vice President of Investor Relations. 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 are Kevin Johnson, Chief Executive Officer; Robyn Denholm, Chief Financial Officer; and Rami Rahim, Executive Vice President, Platform System Division. In addition, Rob Muglia, Executive Vice President, Software Solutions Division is on the call, and will be available for Q&A. Before we continue, I would like to highlight changes to our reporting segments, which are reflected in today's press release. Juniper made changes to better align our business segment reporting to our current organizational structure. Security products previously reported in our Platform Systems Division, PSD segment, are now reported in our Software Solutions Division, SSD segment. Juniper believes this change will provide investors with increased financial reporting transparency, and will enable better insight into the trends driving our business. A summary showing PSD and SSD quarterly revenues on a basis consistent with the new reporting structure is included in Appendix 1 of today's press release.

Please remember when listening to today's call that statements concerning Juniper's business outlooks, economic and market outlook, strategy, 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, and spending by communication service providers and major customers; the network capacity requirements to service providers; the timing of orders and shipments; manufacturing and supply chain constraints; variation of the mix of products sold; customer perception and acceptance of our products; rapid technological and market change; litigation; and other factors listed in our most recent 10-K 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 will 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 the press release furnished with our 8-K filed with the SEC today. For the detailed reconciliation between GAAP and non-GAAP results, please see the Investor Relations section of our website. In general, non-GAAP results exclude certain non-recurring charges, amortization of purchase 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 non-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 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 turn the call over to Kevin.

Kevin Johnson - *Juniper Networks Inc - CEO*

Thanks Kathleen, and welcome, everyone. Our results for the first quarter are in line with the guidance we shared with you in our January conference call. We are off to a good start to 2013, with strength in key markets, and some signs of improving demand trends. To be sure, there are headwinds in certain areas of our business, but overall we executed well against the priorities we outlined last quarter.

I'll review the performance of our two market segments. Service Provider was a good story for us in Q1, with our third consecutive quarter of year-on-year growth. Sequential results reflected anticipated first quarter seasonality. US market for routing continues to strengthen, as we anticipated. Both Verizon and AT&T were 10% customers for us in the quarter, and we continue to see good demand trends with Tier 1 service providers, and other verticals, like content providers and cable. APAC and EMEA were weaker in the quarter, though we are seeing signs of modest improvement in demand in service providers in Europe.

Enterprise is a more challenging market at present, with flat year-on-year performance. A lot of the challenge stems from weak public sector spending, in particular US federal, along with softness in Financial Services. We have communicated steadily over the last several quarters about expected weakness in federal. We do not expect this pattern to improve in the near term. While the enterprise market has seen challenges across several verticals in recent periods, we are committed to continue investment across our businesses of routing, switching, and security, and we are confident in our products and our road map.

I'd like to spend a few minutes discussing three specific areas of focus at Juniper; Service provider routing, data center, and security. Routing was a highlight in the quarter, with particular strength in US carrier. The content and cable segments of US service provider also showed good momentum. We are seeing continued signs that service provider CapEx is improving at a time when our portfolio of new routing products are being well-received by our customers. We continue to expand our reach in edge routing, and we are seeing good customer engagement in the core. We are building on our heritage in service provider innovation, delivering the most complete and differentiated portfolio in our history, most recently with the release of the MX2020.

Data center. Our switching business also performed well in the quarter. We continue to be confident in our opportunity, notwithstanding current macro challenges, particularly as we see the QFabric family of products gain more traction. We're also introducing new products in our EX line, including the EX9200 launched earlier this month. The EX9200 is the industry's most advanced programmable core switch, and will support future software defined networking protocols and emerging applications, both in data center, as well as campus and branch environments.

Security. Despite disappointing results in security in Q1, we believe we are taking the right steps to improve the business. We recently released Security Director, which is being well-received by customers. In addition, there are three pillars to our security strategy. In service provider, it's about leveraging and extending what we believe is a strong position. We continue to scale the high end SRX to handle a large number of concurrent sessions, which differentiates us in the service provider LTE deployments. In the data center, we just announced a refresh of features, including a new capability called Spotlight. We believe this provides us unique differentiation in the data center. We have strong engagements, and we are focused on turning those into customer wins. In campus and branch, we still have work to do, but we have a focused strategy for building an increasingly robust product and feature portfolio, and regaining share.

Wrapping up, we had a solid start to the year. Execution is improving, and that shows in the results. We retain our strong conviction in our opportunity, we believe Juniper is well-positioned to address a very good long-term growth market. Near-term, we are confident in our ability to return to growth in service provider, and strengthen our enterprise business. Our new products continue to gain traction, and we are committed to investing in innovation with a more robust portfolio that can be leveraged across both service provider and enterprise markets. Overall, we are staying true to our 2013 operating principles, and are focused on delivering great products, maintaining our focus on operational execution, and managing costs carefully. The underlying trends driving network investment remain strong, and I'm confident Juniper's positioned for future success.

I'll turn it over now to Rami to discuss highlights from our Platform Systems Division. Rami?

Rami Rahim - *Juniper Networks Inc - EVP, Platform Systems Division*

Thanks, Kevin. It's a pleasure to join the earnings call this quarter. I took over as EVP/GM of the Platform Systems Division, PSD, in November of 2012. I'm responsible for driving strategy, development, and business growth for Juniper's portfolio of routing, switching, and wireless LAN products, as well as for the ongoing evolution of our silicon technology and the Junos operating system. Overall, I am pleased with PSD's results in Q1 2013. Kevin covered the results at a high level, so what I'd like to do is walk through some of the drivers behind the quarter's results, and put them in context. Our five key focus areas when it comes to our platforms are -- core, universal edge, and universal access on the service provider side; the campus on the enterprise side; and the virtualized data center, which spans both service provider and enterprise.

In the service provider business, growth was driven by the business edge and broadband edge segment, where we're seeing wins around the world with large service providers driving broadband deployment. We also recently introduced the MX2020 and the 2 X 100 gig line cards, which we expect to begin ramping as we head through the year. While the overall market for the quarter declined during 2012, we have seen a solid ramp-up for the PTX product family, and the recent introduction of T4000 multichassis strengthens our position in this segment. In the core, Juniper has always been a leader in performance. Today, we have a three-pronged innovation strategy to go after the market that plays out to our strength and gives us a unique opportunity to win.

With the PTX, we've defined a new products category, which is a packet-oriented transport device that moves packets through the network more efficiently than any other system in the world. As an example of the PTX's capability, consider that it has approximately four times the power efficiency of its nearest competitor. In keeping with our goal to drive the benefits of the converged super core to the broadest set of customers, last month we introduced the PTX3000, which is well-suited for smaller core than metro cores because of its form factor. It's less than a foot deep, it fits in environments and locations where a traditional core router would not, it provides transport level of resiliency and performance, an important first step towards full packet optical convergence. Market recognition and customer feedback has been very enthusiastic, and we are on track to ship in the second half of this year.

The second important element of our core strategy consists of the T Series, which remains the best investment protection story in the industry. This platform started shipping a decade ago, but still has very high density line cards today, roughly twice the density of our primary core competitor. And as I mentioned, the recent introduction of the T4000 multichassis product only strengthens this platform's value proposition. And the last weapon in our core arsenal is MX. With MX, we have the ability to introduce a core product that's very service rich, and in so doing we blur the lines between the traditional edge of the network and the traditional core layer of the network, and provide a product that extends services through software deeper into the network. MX continues to show strength in year-over-year revenue growth, and with MX 2020 and high performance line cards now shipping, I expect that that momentum will continue. So I think the combination of these three core technologies really give us the ability to set the agenda and go after a broader core market opportunity.

In the edge, I believe that we have a significantly differentiated universal edge platform. We've got significant traction in the business edge services, great traction in residential edge services, and deployed mobile net software that's moving 4G packets in live networks today. The diversity of applications and use cases has, and continues to be, one of the biggest selling points of MX product family. In fact, we are now seeing more operators leveraging MX universal edge to converge their edge network by running multiple services simultaneously. As an example, we are working with a Tier 1 operator to converge residential services, business services, aggregation, and video delivery services onto a single MX network. The third area is in the axis, which is a really important area, and an opportunity for growth for Juniper. Our goal is quite simple, to extend the success that we've seen in the universal edge by pushing that concept into the axis. Leading operators who have built axis networks optimized for 3G and voice have recognized that 4G essentially changes everything, and new approach to building their axis networks is fundamentally required.

Juniper has built a cost effective axis product that provides the capacity that's necessary to converge business, residential, and mobile services onto a common axis infrastructure. With the ACX family that we introduce last year, we offered a system that provides leading price performance, market leading timing technology, and also some really interesting environmental hardening characteristics. In Q1 2013, we had started shipping the ACX 4000, which is optimized to enhance the mobile subscriber experience, while significantly improving network monetization for its service providers.

Another area that I want to touch on is the data center, and this is really another very interesting area for us. STN is all about introducing agility into the network to keep pace with the rate of change in the compute world. We recognized these trends early when we introduce fabric technologies like QFabric. We are seeing that the adoption for QFabric has started to go up, because customers are recognizing the value, and because we've introduced a new version of the QFabric catering to smaller data centers and data center pods. Gartner recently recognized our innovation by positioning Juniper as a visionary in their data center network infrastructure magic quadrant in February 2013. We are doing well in the campus, where we saw good year-over-year wireless LAN growth, especially in Asia Pacific, where we had our largest wireless LAN win ever.

We continue to build our enterprise portfolio with the launch of the EX9200 programmable switch shipping now. The new EX9200 is the industry's most programmable core switch, which offers the flexibility required to support current and future protocols, emerging applications, and is optimized for both campus and data center environments. We also announced the Junos V Wireless LAN controller, which is delivered as software within a virtual machine, offering the same functionality as the appliance-based hardware wireless LAN controllers, contributing to a unified redundant platform and location agnostic wireless control plan for the end-to-end enterprise. And we announced Junos Space Network Director, a network management application that provides unified manageability for the campus, fixed, and wireless, and we plan to extend that to data centers later this year.

So with all that said, I summarize as follows. We are not confused about the fact that innovation in this area depends on our ability to really move the needle in our silicon technology, our systems, and in our software. All three are fundamental to managing the types of traffic, capacity increases, and service increases that our customers need. I think we're well-positioned in the edge and core with our portfolio today. I think that we have an ability to really grow and expand our universal edge leadership position into the axis layer, and finally I do believe that we've got some great building blocks, both on the platform side and the software side, to build a truly compelling virtualized data center solution and continue our progress in the campus.

Customer feedback around our solutions, and especially recent innovations, has been very positive. Many of our new products are in active customer engagements across all geographies, resulting in trial, design wins, and live deployment. The innovations we are bringing to market are designed in collaboration with our customers, and in response to their needs. And, as with any new architecture, implementation is a multi-stage process. Again, we are pleased with the progress that we are seeing, and how we are delivering against our innovation agenda.

At this point, I'm going to turn over to Robyn. Thank you very much.

Robyn Denholm - *Juniper Networks Inc - CFO*

Thank you, Rami, and good afternoon, everyone. Our first-quarter results were in line with our expectations and reflected our continued focus on disciplined operational execution. We saw broad strength in US service provider this quarter. As anticipated, our enterprise business showed a typical first-quarter decline, with additional expected weakness in federal. Our improved earnings reflect good revenue performance and cost reduction progress. Looking at our demand metrics for the quarter, book-to-bill was below one, which is typical in the first quarter. Product backlog and product deferred revenue both increased year-over-year, and are at healthy levels. And as a reminder, deferred product revenue can fluctuate based on the recognition and timing of specific project deployment.

Total revenue was $1,059 billion, down 7% sequentially, and up 3% year-over-year. Overall, the sequential decline was in line with historical patterns. Sequentially and year-over-year, we saw strong performance in the America service provider sector. In the first quarter, both AT&T and Verizon each accounted for 10% of Juniper's total revenue, reflecting the momentum that we are seeing with US service providers. These customers continue to be strategic for Juniper, deploying our routing, switching, and security products across both their wired and wireless networks. For the first quarter, GAAP diluted earnings per share were $0.18. This includes a $0.05 benefit related to a tax settlement, $0.03 for the renewal of the R&D tax credit, and a $0.02 litigation charge, as well as $0.01 restructuring charge associated with our ongoing productivity and efficiency actions.

Non-GAAP diluted earnings per share were $0.24, down $0.04 sequentially, and up $0.08 year-over-year. The year-over-year increase in EPS was due to a substantial improvement in operating margin fueled by a combination of modest revenue growth, stronger gross margins, and lower operating expenses. Now let me provide some color on revenue by region, market, and business segment. America's revenue was down 2% sequentially, and up 11% year-over-year. We saw continued broad-based strength in US carriers, cable, and content providers, which increased 1% sequentially, and 18% year-over-year. Enterprise was down year-over-year by 2%, with a majority as the result of US federal decline.

Excluding federal, the rest of enterprise increased 5% compared to the first quarter of last year. EMEA revenue was down 14% sequentially, and 5% year-over-year. The sequential decline was primarily driven by lower enterprise revenue. On a year-over-year basis, the decline was a result of Eastern Europe. Excluding this region, the rest of EMEA increased. We saw early indications of improving demand among some service providers across the region. APAC revenue was down 10% sequentially, and 9% year-over-year. The year-over-year decline was primarily due to slower spending by certain large carriers in Japan and Australia, partially offset by gains with regional Service Providers across the theater.

Looking more closely at the markets we address, service provider revenue was $713 million, down 4% sequentially. Revenue was up 4% on a year-over-year basis on increased US service provider demand. Enterprise revenue was $346 million, down 14% sequentially, and flat year-over-year, with a 25% decline in US federal versus the first quarter of 2012. Now let me review our revenue by segment. Platform Systems Division revenue was $809 million, down 7% sequentially, and up 6% year-over-year. Total router product revenue was down 4% sequentially to $514 million. We saw a good sequential increase in core routing, and edge routing continues to be strong. Routing increased by 7% year-over-year, and we saw continued momentum from MX and PTX.

As I noted last quarter, we will continue to closely manage our supply chain in response to increasing service provider edge router demand. Total switching product revenue was $132 million, down 10% sequentially, and up 6% year-over-year. The sequential change reflects good content service provider growth, offset by a seasonal enterprise decline. The year-over-year increase is primarily due to growth in the QFabric product family. SSD revenue in the first quarter was $250 million, down 9% sequentially, and 6% year-over-year. Total security product revenue was $137 million, down 19% both sequentially and year-over-year. Of the $32 million year-over-year decline, $20 million is due to fluctuations of the timing of service provider deployment.

Enterprise security decreased $12 million, as the screen OS product declined more rapidly than the growth of SRX. We remain focused on stabilizing our enterprise security share in 2013. We continue to stay positive momentum with our new product, and are on track toward achieving our goal of $150 million in revenues from new products in the fourth quarter. In the first quarter, revenue from these products were over $85 million. In order of magnitude, T4000, PTX, and QFabric provided the bulk of the revenue. Also, we are seeing good customer interest in our ACX universal backhaul products.

Moving onto gross margins and operating expenses. Non-GAAP gross margins for the first quarter was 64.6%, compared to 65.3% last quarter, reflecting the lower volume. The two percentage point improvement year-over-year demonstrates the progress we've made on supply chain cost reduction, as well as greater efficiency in our delivery of services and customer support. Non-GAAP product gross margins were 65.5%, and non-GAAP services gross margins were 62.1%. Non-GAAP operating expenses decreased $19 million, or 4% sequentially, and 1% year-over-year, to $518 million. The OpEx decline is a result of the progress we've made in aligning our cost structure to our focus priority. Looking at headcount, we ended the quarter with 9322 employees, a sequential increase of 88, as we continue to balance our geographic personnel mix to optimize our cost structure.

Non-GAAP operating margin for the quarter was 15.7%. This reflects a substantial year-over-year improvement in financial metrics, including a 3% growth in revenue, a 2% expansion of our total gross margin, and a 1% decrease in operating expenses. I am pleased with our progress this quarter towards our long-term financial model. Turning to an explanation of our taxes this quarter. The non-GAAP tax rate was 19.8%, down seven points versus the prior quarter, due primarily to the $15 million one-time benefit of the 2012 R&D tax credit, and the current effects of the 2013 R&D tax credit. The GAAP tax rate was a negative 18.3% for the quarter, primarily as a result of the tax settlement with the IRS.

Looking at the balance sheet, we ended the quarter with $2.7 billion of net cash and investment. For the quarter, we saw a net cash outflow from operations of $9 million, due mainly to a sequential increase in accounts receivable, lower net income, annual payments for incentive compensation, and the timing of payments to our supply chain. In Q2, we expect to return to our historical pattern of strong positive cash flow. DSO was at the high end of our historical range at 45 days in the quarter, up from 35 days last quarter, due primarily to shipment linearity. Capital expenditures were $72 million, down 22% from the fourth quarter as we near the completion of our Sunnyvale campus. We repurchased 6.2 million shares for $130 million. We have $438 million remaining on our current authorization, and expect to calibrate our buybacks in future quarters with market conditions.

Now I will review our outlook. As a reminder, these metrics are provided on a non-GAAP basis, except for revenue and share count. As a reminder, these metrics are provided on a non-GAAP basis, except for revenue and share count. Our outlook for the June quarter reflects our expectation of continued weakness in the enterprise customer spending environment. In service provider, we expect to see a continuation of US service provider capital spending, and some modest improvement in demand emerging in EMEA.

Our new products continue to build momentum, especially in routing, and we remain focused on disciplined operational execution, while driving revenue growth. For the second quarter, we expect revenues to range from $1.070 billion to $1.100 billion. Gross margins are expected to be in the range of 64% to 65%. Operating expenses are expected to be $510 million, plus or minus $5 million, and with this lower operating expense run rate, we remain on track to deliver on our cost reduction goals for the year. At the midpoint of guidance, operating margins are expected to be 17.5%. This is expected to result in non-GAAP diluted EPS of between $0.22 and $0.26 per share, assuming a flat share count, and a tax rate of 29%, which is inclusive of the R&D tax credit.

To summarize, we expect the near-term market conditions to remain uncertain, with modest growth in the markets we serve. Given that environment, we will continue to navigate with a disciplined approach, executing with agility, taking share in routing and switching, and capitalizing on the market opportunities at stake. We are focused on driving year-over-year operating margin expansion, generating strong cash flows, and prudently allocating capital. And we will maintain our focus on delivering innovation and revenue growth over the long term. I would like to thank our employees for their continued dedication and commitment to successfully executing our strategy.

And now let's open the call to questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now be conducting a question-and-answer session.

(Operator Instructions)

Our first question is from Rod Hall of JP Morgan.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Yes, thanks, guys, for taking my question. Just had a couple for you. I wanted to talk a little bit -- get you to talk a little bit more about the underlying trends in routing, and Rami, and it sounds like things are definitely starting to improve there. I wonder if you could give us any kind of regional commentary in terms of what you're expecting in Europe? I mean, for instance, do you expect Europe to actually grow significantly this year, or do you think it's just going to be more stable than it was last year? What kind of declines are you seeing there? And also on a T4000, if you could just clarify specifically what trends you're seeing there that give you guys more confidence? I wasn't sure I came away with a real clear picture of what you're saying about the T4000.

And then also, while we're on routing, if you could talk a little bit about PTS trials? If you could give us any idea how many people are actually trialing this product right now, and what the pipeline there looks like, and then the last thing is the EX9200 is not a Qfabric switch, and I just wonder, Kevin, if maybe you could talk about the strategy in switching? Are you guys hedging your bets a little bit? Do you have, now, a two-pronged approach? One that is QFabric-oriented, but also one that is going to be more non-QFabric (inaudible) shifting away?

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Rod, it's Kathleen. Do you want to prioritize the top two of those?

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Okay. Why don't you talk about T4000 ramp and what's going on there, and then the switching strategy would be great.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay, fantastic.

Rami Rahim - *Juniper Networks Inc - EVP, Platform Systems Division*

Okay, so let me start. First of all, maybe just a couple comments on some of the segments, and how we characterize our Routing business. I'd say that we were pleased with the balanced approach, and actually the success that we saw from a standpoint of the very segments that bought our routing products. So we saw good growth in cable operator space with traditional telcos, and also in content providers, and each of these different segments bought for different reasons.

Clearly, cable operators are dealing with massive growth of video traffic. So this plays right to our strengths from the standpoint of offering high performance systems. The telcos, a lot of consolidation, convergence, again, it's all about universal edge. The super core products plays to that sort of trend that's happening in the industry. And last thing on the content provider, also known as Web 2.0, it's about peering and data centers, and data center interconnect. Again, all sort of trends that benefit from the high performance that we offer in many of our products and solutions.

On the T4000, certainly what we saw, as Robyn mentioned, is that we saw sequential strength in our core overall. I will say that part of that strength came from the T4000 itself in the Q1 time frame. I will say that still today, operators are more focused on the drivers in the edge of the network. So there is a greater demand, if you will, for keeping up with the capacity, the services, and the connectivity at the edge of the network today, but sequentially we're pleased with the trends that we saw in the core. You asked about the multichassis. We did announce and started to offer new multichassis product for the T4000.

This is part of the natural evolution of the T series. We offered a multichassis solution for the T640. We did it again for the T1600, and now we're doing it for the T4000. It's not the global sort of customer base for the T series that are interested in this product, but you clearly, this is a massively scalable solution that's very appealing to our largest customers, and we're engaged with a number of Tier 1 operators around the world for that solution.

The last thing I'll just mention on the switching side, there is no change in strategy here. In fact, we've always embarked on a two-pronged strategy for our switching solutions, both from the data center and the campus. In the data center, in particular, we know that there is a subset of customers that want to go down a tiered approach, that we have a two-tier solution that consists of the EX product line.

We've just strengthened the EX product line with the introduction of the EX9200, which preserved that architectural message of a two-tier solution, but brings in a level of programmability that I think is really going to help us, especially in this day and age where protocols are revolving, SDN is coming into play, and our customers are trying to figure what that means for them from a solution standpoint.

The other dimension to our strategy remains very consistent, which is that of the QFabric, a single-tier architecture. The QFabric, as you know, is our flagship data center product, and we did see, again, a bit more momentum there because of the fact that we introduced the micro fabric, as well as some additional features that have been waiting -- that some of our customers have been waiting for.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Next question?

Operator

Thank you. The next question is from Kevin Dennean of Citi. Please go ahead.

Kevin Dennean - *Citigroup - Analyst*

Great. Thanks very much. Thanks for taking my question. I guess, Robyn, quick one for you. Previously you discussed about $150 million in cost savings split between cost of sales and OpEx. How should we think about the pace of those cost reductions through the year? You're guiding, I think, at the mid point $510 million for the next quarter, which is a modest reduction year-over-year, but if you could talk a little bit about the trajectory and what we should expect in second half OpEx?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, so in terms of the cost targets that we've put out there, $150 million between COGS and OpEx, and about 75%, 80% in the OpEx area. We are making very good progress against that. You saw the sequential decline from Q4 to Q1, where typically we see an increase in the Q1 spending, given the factors that influence Q1 around salaries and that type of thing. So we've actually -- we believe we've made good progress in terms of the cost reductions. As I mentioned on the Q4 earning call, many of the reduction in force, or the workforce sort of reductions have actually happened in terms of the Q4 time frame. We are continuing to work on supply chain reductions, as well as the overall infrastructure in the Company facilities and that type of thing, and that will be ongoing throughout Q2 and Q3, especially. So my view is, we're on track to meet the targets that we set out, and I'm pleased with the progress that we've made.

Kevin Dennean - *Citigroup - Analyst*

So Kathleen, just following up on that, should we expect the bulk of the remaining cost savings, particularly in OpEx, to be concentrated in fourth quarter, or do you expect it to be somewhat even between the third and fourth quarters?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, I would, at this point, I think that we'll see it evenly between third and fourth quarter, in terms of the reduction.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay. Next question?

Operator

Thank you. The next question is from Mark McKechnie of Evercore Partners.

Mark McKechnie - *Evercore Partners - Analyst*

So my question is about the new products. You said they were about $85 million this quarter towards your goal of $150 million. Maybe, Robyn, can you give us a sense for the margin profile of the new products relative to your corporate margins here?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, thanks, Mark. In terms of the new products, we're making good progress against the goal that we set for Q4 of 2013 of achieving a quarterly run rate of $150 million. As I mentioned in my prepared remarks, that's largely coming from the routing products and QFabric. So, that's actually the bulk of the over $85 million in the first quarter that we saw. In terms of margin profile, if you go back to my fan presentation, we actually put what was at or above the corporate average in terms of product gross margins, and clearly the routing products are above the corporate average, ACX, the axis product, which is in the five products in terms of the new product target, not a material revenue at this point, but is in that number. They were below the corporate average, and switching, and sort of the middle of that. So our view is, we're well on track for the $150 million for the fourth quarter.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay, our next question?

Operator

Thank you. The next question is from Amitabh Passi of UBS.

Amitabh Passi - *UBS - Analyst*

Hi, thank you. Kevin, I was wondering if you could shed more light on your expectations for Asia-Pac. It looks like that region continues to struggle. And then I had a follow-up for Robyn, just in terms of your buyback capacity, if you could just remind us what's left in the program?

Kevin Dennean - *Citigroup - Analyst*

Yes, Amitabh, thanks for the question. On Asia-Pacific, when you look at the Service Provider business in Asia-Pacific, you almost have to look at it country by country. It's not necessarily a homogenous region. So as Robyn commented, we saw some slowdowns in Japan and Australia. I think India, given the way that spectrum has been allocated and some of the unique challenges those service providers face, I think that's a unique market, and yet it's one that I think has opportunity, but not one on the service provider side that we've seen significant uptick in. We continue to compete well in certain opportunities in China, and some of the partnership work that we've done there.

So it really does vary on the service provider side, and then I think on the enterprise side globally, certainly our largest verticals that we focus on in the enterprise side would be Financial Services and federal, specifically US Federal. But I think relative to some of the work that we see, or happening on the enterprise side, I think Asia-Pacific has had their share of challenges, as well. But overall, I think you kind of have to look at it country by country, and it's mixed. And I think there's certain countries that I think we see opportunity, are doing well, and others that have been a little bit of a slowdown. Robyn?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, in terms of the buyback, we have $438 million remaining on the current authorization of the buyback.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay, next question?

Operator

Thank you. The next question is from Brian Marshall of ISI Group.

Stephen Patel - *ISI Group - Analyst*

Hi, thanks. This is Stephen Patel for Brian. You mentioned service provider is starting to sound a little better, especially in the US, and even a little bit in EMEA, as well. Can you talk more about what those customers are telling you, and what kind of visibility you have on their plans for the rest of the year?

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes, I'll kickoff the answer, Stephen, and then I'll let Rami add to it. I think we, two quarters ago, I think started indicating that we saw some positive trends in terms of an uptick in North America service provider demand, and that was really driven by visibility to specific projects that we're involved in and that we're unfolding, and now we're starting to see those projects come to fruition and implementation. I think this is the quarter, last couple of quarters, where we also now started to see a few of those types of projects start to emerge in Europe, with service providers in Europe.

In addition, in the US, we saw specific strength in the content service providers, the Web 2.0 types of companies, as well as cable. And so that's a positive indicator. So much of what we look for is when we win a specific project, there's a certain amount of planning and configuration and architecture work that goes into it, and then you start into the deployment phases. And so, when we just look at the portfolio of projects that are in progress that we've won and we're in progress, and look at sort of how the capital expenditures will then -- will follow as they're aligned with those projects, we feel like we've got some positive trends in the US and some good signals for some positive trends beginning to emerge in Europe. And Rami, I'll let you comment further.

Rami Rahim - *Juniper Networks Inc - EVP, Platform Systems Division*

Yes, I think Kevin covered most of it. I'll just add a couple things. In our discussions with customers around the world, it's clear that traffic is continuing to grow, and this forms, of course, the foundation of much of our Business. So it just comes down now to how much of a risk operators want to take, or how hot they want to run their network before they want to invest. Clearly, as long as that traffic continues to increase, which we see it increasing everywhere, that investment cycle, especially in cost centers like the core, will come, eventually. It's just a matter of trying to predict when, and it's very difficult to do so.

The other element of the discussion is around service generation, which is all around things like either the universal edge, our SDN strategy, our service training approach, and so forth. This discussion, and these engagements, are really happening everywhere, but as Kevin mentioned, the pick-up that we're seeing, the early signs we're seeing, are mostly prominent in the US and certain parts of EMEA.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Next question, please?

Operator

Thank you. The next question is from Tal Liani of Banc of America/Merill Lynch. Please go ahead.

Tal Liani - *BofA Merrill Lynch - Analyst*

Hey, thank you. AT&T just reported about 20% miss to the CapEx plan for the quarter, and on the other hand, you have strength, with AT&T specifically. You mentioned it was a 10% customer. Can you discuss the nature of service provider revenues this quarter? Are these related to specific projects that there is concentration in one or two projects, or is it more broad-based? It's just that your commentary specifically to AT&T is so different than what they said on CapEx that I'm trying to understand the disconnect. Thanks.

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes, Tal. This is Kevin. Thanks for the question. I'm going to stay away from commenting on specifics about any one individual customer. But I think that the broad answer is that clearly in our relationships with customers, we work to diversify not only the set of projects that we're working on, but the depth of work that we're doing in each of those projects. And I think in some customer situations it's new design wins, it's adding new projects, and in other customer situations, it's a balance of several projects. I think generally in the US, what we're seeing is a wider range of projects that we're getting involved in, and that's strategically what we've been driving to do with the universal edge, and I'll let Rami comment more, but the universal edge and the MX product family has really become a real workhorse for us and for our customers.

And the fact that we're seeing the convergence of -- if it's just the consumer plus the business services in a B&G type of implementation, that's creating opportunity for customers to consolidate networks and get the economic benefits of doing that, and leverage their investment in the MX to do that. So that's an example of one of the drivers that we've seen consistently around the world, in customers in all three theatres.

But I think the general answer is that in the US, it's probably a range of projects that we're involved in, and certainly in a range of customers, and I think, as we commented in Europe, what we're seeing now is the size of new projects being kicked off and launched in Europe, which is a signal that they are now starting to ramp with some new work.

And Rami, why don't I let you comment further on your perspective.

Rami Rahim - *Juniper Networks Inc - EVP, Platform Systems Division*

Yes, sure. Just say that it's not unusual, especially with our largest customers, that we're engaging on a number of projects simultaneously, and as Kevin mentioned, even with a single platform like the MX, you can be participating in project to solve very different challenges that our customers have with that platform being used in different applications. So that continues to happen. Increasingly, for example, we're not just having a conversation about wireline, but we're also talking about wireless projects, and sort of solutions that our customers demand as they move their network from 2G, 3G, to 4G.

We mentioned, for example, in the last part of 2012 we introduced ACX. This is all about a bookend to solutions that takes many of our existing products and pushes them into the wireless side of the sort of the solutions base for our customers. We're having a lot of those discussions, and they're happening parallel to many other sort of discussions, as well, with a variety of different products.

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes, Tal. Just a final point on the comments that Rami and I made. We talk a lot about the edge and what's happening on axis, but many of these cases we're also doing work in the core. I mean, We saw a good uptake of PTX, as well as sequential increase in T Series. So, I mean, that just sort of supports the fact, I think, and certainly in our North American service providers, it's a range of projects, it's a variety of projects that's contributing.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Next question, please?

Operator

Thank you. The next question is from George Notter of Jefferies.

George Notter - *Jefferies & Company - Analyst*

Hi, thanks very much, guys. I wanted to ask for some more commentary on your Federal business. Obviously, it was weak this quarter, but I guess I'm trying to understand exactly what's driving that. Certainly, I would imagine the sequester is a big piece of the story here, but are you seeing smaller deal sizes? Are you seeing deal push-outs? Is the business, just are deals being cancelled? I mean, any kind of flavor you could give us there would be great. And then also I'd love to understand what you've got baked into expectations for the Federal business for Q2. Thanks.

Kevin Johnson - *Juniper Networks Inc - CEO*

I'll take the first part of your question, George, and then I'll let Robyn comment on Q2 guide. I think the answer is in Federal, it's all of the above. When they're trying to find ways to conserve capital and reduce investment, or reduce cost, they're going to look every place they can. That's not to say there haven't been some orders and some projects that we've been engaged in, but the net is, I think, is there's some areas that spending has been curtailed, others where projects have been cut back, and yet some areas where projects have still gone forward.

And so, our Federal team has worked very hard to navigate sort of the challenges that we know our federal customer is trying to deal with and make sure that we're focused in the right areas, and I think Robyn commented on the decline that we saw year-on-year in our Federal revenue. Do you want to comment on the guide, Robyn?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, sure. So George, in terms of the second quarter, what I did say in terms of the guidance is we expect the same sort of trends in the second quarter. So, we're expecting enterprise to be soft in the second quarter, given the ongoing challenges in the budget environment with Federal.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay. Next question, please?

Operator

Thank you. The next question is from Ehud Gelblum of Morgan Stanley. Please go ahead.

Ehud Gelblum - *Morgan Stanley - Analyst*

Hey, guys, how are you? I have a litany of questions and I'll try and compress them. First, Rami, if you can just touch on some of the claims that Alcatel Lucent has been making with the new 7950. They claim they have getting aggressive out there and taking share, specifically from you guys. So if you can just give a brief overview of what you are or are not seeing in the market on routing.

Then on security, it was down 20% last quarter. I think you said that Rand's SRX orders were up 17%, and high-end SRX off 19%. I didn't hear similar quarters revenue that you spoke of those. I didn't hear similar numbers this quarter. So Robyn, if you can give color around what the two different types of SRX did in terms of revenue this quarter to get to the down 20%, give us some color there, and what you're expecting in guidance with that, that would be helpful.

I'm switching. I was surprised it was down as much as it was. It was down 10%, 11%, and orders you said last quarter were up 19% in switching. So I just want to make sure I'm comparing apples to apples, and if we can get an understanding why the orders didn't necessarily translating into higher switching revenue, and how QFabric plays into that, because Kevin, it sounded like you said QFabric got stronger again. If you can just give us color on QFabric, and then with customers, and how that played into that. So a lot of questions.

Kevin Johnson - *Juniper Networks Inc - CEO*

Okay, Rami, I'll let you take the first one (multiple speakers)

Rami Rahim - *Juniper Networks Inc - EVP, Platform Systems Division*

Okay, yes. Certainly. So what I'd say this, is that first I don't underestimate any of our competitors. So a lot of respect for all of our competitors. But that said, building the massively scalable ultra large core systems that our customers demand is not an easy thing to do, and this is part of Juniper's strength and our DNA. And as I mentioned in my opening remarks, I think that we have a three-pronged innovation strategy that, quite frankly, whether you talk about Alcatel or any other competitor is going to be difficult for them to match.

Everything from as the investment protection story that we offer with the T series to the PTX, which is really a new breed of core transport, super core router that really nobody else has from the standpoint of efficiency, power efficiency, transport capability, optical integration. We've just strengthened that with the announcement of the PTX3000. And last but not least, is the MX2020, which again, we've just introduced along with denser line cards for the customer that wants to do more of a service ridge core. So the combination of these three products gives me confidence that I think we're going to do very well against incumbent competitors, as well as newer competitors that are trying to get into the space.

Kevin Johnson - *Juniper Networks Inc - CEO*

Okay, then on the question on security, maybe Robyn, why don't you start with the numbers and then let Bob comment on sort of the focus we have on the Security business.

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes, so in terms of the security business, I talked about year-over-year that there was a $32 million decline year-over-year, and $20 million of it was in the SP space, and that SP space is high in SRX. On the Enterprise side, SRX did increase year-over-year, but the net screen RX products are declining at a faster rate than the rate of increase in SRX, and as you know, Ehud, that's where we've been focused on, if you like, turning the business around. And so, Bob, do you want to comment on the enterprise security?

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

Sure. Let me make a comment on both sectors, if I would. On the service provider, as you mentioned, we always see this revenue to be lumpy from quarter to quarter. And right now, we're also in the middle of a product transition as we're bringing out a next generation of service blade that increases our per session capacity to 100 million sessions and provides our service provider customers with a continued leading performance that they've come to expect out of the SRX. So that's one of the factors that we expect has had some implication in the service provider space, although the deals just come in at different quarters, and that has been true for some time.

In the enterprise, in the data center space, which really is for both the service provider and the enterprise, we have seen some increased interest, certainly from our customers, and we have some confidence that this will lead to long-term strength in the business. As we've introduced new products in this space, such as web app secure, and our recent introduction of Spotlight, which fingerprints hackers using technology that is unavailable from anyone else in the industry, and we've got some very strong positive conversations with leading CSOs of major enterprise and service provider customers over the past quarter in the space. We see the data center as an area where -- and we are, once again return to a very competitive position, and in fact have some leading edge technology.

The area where we have been -- have had more challenge, and this is consistent with the conversations we've been having for a year, is in the campus and branch space, which is really in the enterprise, and there, there are still some areas of product efficiency that we're working to correct. We have introduced, and have talked about in previous quarters, our Security Director in the marketplace.

We've seen good acceptance of Security Director with customers such as Revlon, Echo Petro in Colombia, a major Columbian oil and gas company, as well as Meijer, a Midwestern retailer are three examples of reference customers who have successfully adopted Security Director and are using it to manage their systems. We have new things we need to do in that space still, particularly in the reporting area, but we are continuing to focus on all three areas of security, and have long term confidence in the business.

Kevin Johnson - *Juniper Networks Inc - CEO*

So then the third question, Ehud, was in the area of switching, and overall the Switching business grew 6% year-on-year, and certainly that even accounted for the declines that we saw in Federal and other parts of enterprise, and I think much of that was driven by -- part of that was driven by QFabric that continues to grow. And QFabric, a little color behind that. I think we, since that product is really oriented in many ways to large data center types of needs, we saw in this particular quarter a deployment of one of our large customers in a large data center that contributed to that, and in terms of the bridge between the orders in Q4 and Q1, Robyn, do you want to comment?

Robyn Denholm - *Juniper Networks Inc - CFO*

Yes. So in Q4, Ehud, we actually said that it was service provider demand that was in backlog, if you like, and we did see that coming through in the results this quarter. We talked about switching being up in the service provider space in the quarter, even though we did see declines in the enterprise space in the quarter.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

So, we have time for one more question.

Operator

Thank you. The last question comes from Subu Subumanian of the Juda Group. Please go ahead.

Subu Subrahmanyan - *The Juda Group - Analyst*

Thank you. My question was to follow up on security. I wanted to see if you could talk about, if you feel like you're reaching a bottom in security, given the new product transitions you're seeing, as well as some of the new capabilities of the campus data center, or if you expect to see that at some point, just given the quarterly revenue run rate? Is that kind of a multi-year low for the quarterly revenues?

Kevin Johnson - *Juniper Networks Inc - CEO*

Yes, Subu. Let me sort of kick off and just reiterate a way that I think it's important for you to think about this, and then I'll let Bob comment. What Bob talked about is three different areas of our Security business. The first one being service provider, and we feel we're at a very good position with service providers. The revenue is lumpy. This was a quarter that it was low, but we feel like with the R&D we've done, and the ability to take the SRX to handle 100 million concurrent sessions, that value proposition for service providers is their securing LTE traffic on the mobile internet is and continues to be a strong value proposition.

So that part of our security business we feel very good about. Yes, revenue is lumpy, but we've got new design wins, our largest customers are continuing to deploy, we've got new innovation that addresses their need of scale, service providers' in good shape in securing mobile internet.

The second bucket is data center, and I think as Bob highlighted, I think the new innovation that we delivered in data center, combined with our SRX and SSLBBM technology, we feel good about our data center offerings. We've got good customer interest, we have to work to make sure we convert that to revenue. So I think data center, we feel about. And the area that we know we still have work to do is in that campus and branch area. So you net that out, I think -- and Robyn's comments that of the year-on-year decrease in security, $20 million of that, roughly, was service provider, and that's lumpy, and we're confident we've got the right set of solutions there.

So it was $10 million that was related to enterprise, and we think that we've got a good value proposition in data center, and we've still got work to do in campus. So that's kind of the framework to think about it. So the question is, we've shifted the bulk of our revenue now to the SRX, and so the older screen OS products will continue to decline, and it's our ability to then offset that with faster growth on the SRX, and we feel stronger in service provider and data center than campus and branch. I think that's the net of what Bob outlined.

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

That exactly right, Kevin. I think that we're in a product transition cycle, a multi-quarter product transition cycle from the screen OS generation of products to the SRX. The SRX brings us strength in service provider, which we've never had before, and that is an area where particularly as service providers do LTE buildouts, we see the ability to profit from that. Meanwhile, we need to insure that we double down in the enterprise segment. We feel like we've made good progress in the data center space with what we've introduced. We still have work to do in campus and branch, which is a large part of the enterprise market, but that's an area of continued focus in the team, and this is a multi-quarter transition.

Kathleen Nemeth - *Juniper Networks Inc - VP IR*

Okay, thank you very much. That is all the time we have today. We would like to thank you again. We recognize that today is a very busy day in terms of companies reporting, and we appreciate your interest in Juniper Networks. Thank you.

Operator

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.