Company Name: Cisco
Company Ticker: CSCO US
Date: 2017-11-15
Event Description: Q1 2018 Earnings Call

Market Cap: 168,905.29
Current PX: 34.11
YTD Change($): +3.89
YTD Change(%): +12.872

Bloomberg Estimates - EPS
Current Quarter: 0.586
Current Year: 2.447
Bloomberg Estimates - Sales
Current Quarter: 11691.955
Current Year: 48158.480

Q1 2018 Earnings Call

Company Participants

- Marilyn Mora
- Charles H. Robbins
- Kelly A. Kramer

Other Participants

- Pierre C. Ferragu
- Mark Moskowitz
- Steven Milunovich
- Vijay Bhagavath
- Paul J. Silverstein
- Ittai Kidron
- George C. Notter
- Tal Liani
- Mitch Steves
- James E. Faucette
- Simon M. Leopold
- Jeffrey Thomas Kvaal
- Erik L. Suppiger
- Jim Suva

MANAGEMENT DISCUSSION SECTION

Marilyn Mora

Q1 Highlights

GAAP and Non-GAAP Financial Measures

- Income statements, full GAAP to non-GAAP reconciliation information, balance sheets, cash flow statements, and other financial information can also be found in the Financial Information section of our Investor Relations website

Business Model

- As a reminder, effective in Q1, we began reporting our revenue in the following categories:
  - Infrastructure Platforms
  - Applications
  - Security
  - Other Products and Services

- As discussed in our Q4 earnings call and in our October 23 press release, this change better aligns our product categories with our evolving business model
- Our segments will continue to be based on geographies which consists of the Americas, EMEA, and APJC
- So, this change only impacts how we report revenue by product category
  - We've include quarterly reclassified revenue amounts for the last three FYs on our website
- Click on the financial reporting section of the website to access these statements
- Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results, and we'll discuss product results in terms of revenue and geographic and customer results in terms of product orders unless stated otherwise
  - All comparisons throughout this call will be made on a y-over-y basis unless stated otherwise

Charles H. Robbins

Business Highlights

Revenue and Non-GAAP EPS

- Our results this quarter demonstrate the continued progress we're make on our strategic priorities
- In Q1 we delivered a solid quarter with revenue of $12.1B and non-GAAP EPS of $0.61
- We are seeing great traction with our new intent-based networking solutions, delivering accelerated innovation across our portfolio and offering a broader range of new consumption options to our customers, resulting in strong increases in our software and subscription revenue
- The progress we've made resulted in all three of our geographic regions returning to orders growth during Q1

New Connections

- Cisco has always been about connecting people, information and machines at scale
- Today, the network is becoming more pervasive and critical to business success as billions of new connections are added
- We expect these new connections will become increasingly automated, intelligent and secure, delivering unprecedented insights and intelligence to our customers
- Cisco's vision is to deliver highly secure intuitive technology across our portfolio that is designed to constantly learn, adapt and protect to drive business outcomes with greater speed and agility
  - This extends to the network, next generation data center architectures, advanced IoT applications end-to-end analytics and our Collaboration technologies

Digital Business

- Our vision is resonating with customers and partners around the world as we help them build more secure intelligent platforms for their digital businesses

- Today, most of our customers are operating in complex, multi-cloud environments and Cisco is well positioned to provide them with networking capabilities, enterprise class security and support together with cloud scale, agility and economics

New Partnership with Google

- Our new partnership with Google is a good example of this
- Over the last few months our engineering teams have been working closely together to jointly develop a new hybrid cloud solution that is designed to enable applications and services to be deployed, managed and secured across on-premise environments, as well as Google Cloud Platform, bringing the best of cloud to the enterprise
  - This partnership is an example of the work we are doing with all of the large web-scale providers
- We're also investing to develop and acquire new technologies to extend our Multicloud Portfolio
- This includes ACI anywhere, which we announced this quarter and acquisitions such as:
  - CliQr
  - OpenDNS
  - Cloudlock
  - AppDynamics
  - And Viptela

Infrastructure Platform

- Now I'd like to cover some key business highlights in our new product reporting categories
- First, let's start with Infrastructure Platforms
- Our launch of The Network
- Intuitive. in June is an example of the investment and innovation we're driving in our core business
  - These new intent-based networking capabilities are providing customers' unparalleled insights and intelligence, together with highly-differentiated security and programmability
- Our new subscription-based Catalyst 9000 switching platform has been adopted by more than 1,100 customers in just over three months
- We expect continued momentum throughout FY2018, and we're pleased that the vast majority of Catalyst 9000 customers are buying our most advanced software subscription offer

ACI

- Additionally, we saw a good performance in our next-generation data center switching platforms as customers continue to shift to 10 gig, 40 gig and 100 gig architectures and embrace multi-cloud adoption
- We continue to advance our intent-based networking for data center and private cloud environments with the latest software release of ACI
- Over 4,000 ACI customers are benefiting from increased business agility with network automation, simplified management and improved security

- Going forward, we see a tremendous opportunity to benefit from a shift in customer demand from standalone products to integrated platforms with our intent-based infrastructure portfolio providing unmatched benefits

Applications

- Now turning to applications
- Applications are absolutely central to every digital business strategy
- To maximize their effectiveness, companies require a highly-secure network that closely monitors applications and workload performance across a complex multi-cloud environment
- Our acquisition of AppDynamics is core to our capability of providing end-to-end analytics, from the network to the data center to the application

Acquisition of Perspica

- Within our Applications business, we are enabling new capabilities based on advanced AI and machine learning across our portfolio
- An example of this is our acquisition of Perspica, providing deep machine learning driven analytics to further extend AppDynamics' leading capabilities in application intelligence
  - Additionally, we announced our latest innovation on the Cisco Spark platform, Spark Assistant, which is the world's first enterprise-ready, AI-powered voice assistant to further enhance our customers' meeting experience

Acquisition of BroadSoft

- Our intended acquisition of BroadSoft will enhance our subscription and cloud-based business
- BroadSoft has 19mm subscribers in the growing cloud voice and contact center space and will enable Cisco to offer an even broader portfolio of collaboration solutions to our customers, on-premise and in the cloud
- We expect this acquisition to accelerate the pace of innovation in our Collaboration business and we see many opportunities to extend the reach of the BroadSoft portfolio

Security

- Moving to Security
- With an expanding threat landscape, cybersecurity is the number one priority for businesses worldwide and is at the heart of every company's digital strategy
- In a multi-cloud world, as our customers' environments become increasingly distributed, security requirements only increase
- At Cisco, security continues to be a strategic imperative and fundamental to everything we do
- As customers adopt and advance intent-based networking, our end-to-end security is the foundation to keep our customers protected from advanced threats

Strategy

- This architecture, combined with the best-of-breed portfolio across the network, endpoint and cloud, enables our customers to reduce the time to detection, as well as complexity and cost
- As a result, we believe Cisco is delivering the most effective and comprehensive security solutions in the market
  - This differentiated strategy drove the 8% revenue growth in our Security portfolio, and we also saw continued momentum in our Security deferred revenue, with 42% growth

Summary

To summarize, we delivered a solid quarter as we continue to execute well against our strategic priorities

I firmly believe that Cisco is well positioned to capture long-term growth opportunities ahead

We remain focused on providing our customers with the most innovative portfolio of offerings in the industry, powered by intent-based capabilities and delivered through a range of consumption models providing more flexibility than ever before

Kelly A. Kramer

Financial Highlights

Revenue, Non-GAAP Operating Margin and EPS

- I'll start with a summary of our financial results for the quarter, followed by Q2 outlook
- Total revenue was $12.1B, down 2%
- We continue to focus on driving margins and profitability, with non-GAAP operating margin of 30.4%
- Non-GAAP EPS was $0.61 and operating cash flow was strong, growing 13% to $3.1B.
- The role of enterprise IT is dramatically changing with the move to an application-centric focus and adoption of hybrid cloud architectures, with customers increasingly seeing the value of integrated platforms over standalone products

Product Reporting Category

- Cisco's intent-driven architecture with a focus on simplicity, automation and security allows enterprises to manage and govern the interactions of users, devices and applications across the environment
- Starting in Q1, to better reflect these shifts we've changed our product reporting categories which are now Infrastructure Platforms, Applications, Security, Other Products and Services

Product Revenue Growth

- So let me give you a little bit more detail on our Q1 revenue
- Total product revenue was down 3%, Infrastructure Platforms declined 4%, with the vast majority of the decline driven by routing products
  - This was driven by continued weakness in service provider and a slowdown in enterprise routing

- Our switching revenue was down modestly but we saw good momentum on orders in campus switching with The Network
- Intuitive. launch
  - Additionally, we did see continued strong wireless revenue performance and solid uptake of our HyperFlex data center offering

Applications

- Let's move on to Applications
- To remind you, Applications is made up of our Collaboration portfolio of Unified Communications, Conferencing and TelePresence as well as our IoT and application software businesses such as AppDynamics and Jasper
- Applications increased 6% in total, with Collaboration up modestly and AppDynamics driving most of the increase
  - We did see strong growth in deferred revenue of 18%
- There was also a strong increase in the unbilled deferred, which is not on the balance sheet, bringing the combined total of deferred revenue plus unbilled deferred up 32%

Security

- Security was up 8% with strong performance in unified threat, advanced threat and web security, and deferred revenue grew 42% as we continued to drive more subscription-based software offers
- Service revenue was up 1% driven by growth in software and solutions services
- During the quarter, we introduced a new portfolio of subscription offers called Business Critical and High Value Services powered by AI to predict future IT failures before they happen
  - We drove good growth in deferred revenue, which was up 10% in total, with product up 16% and services up 5%
- Deferred product revenue from our recurring software and subscription offers was up 37% to $5.2B

Software Offerings

- We continue to transform our business delivering more software offerings and driving more subscriptions and recurring revenues
- In Q1, we generated 32% of our total revenue from recurring offers, an increase of over 3 points from a year ago
- Revenue from software subscriptions was 52% of our software revenue

Orders Growth

- In terms of orders in Q1, total products orders grew 1%
- Looking at our geographies, Americas grew 1%, EMEA was up 2% and APJC grew 1%
- Total emerging markets declined 6% with the BRICs less Mexico also down 9%

- In our customer segment, enterprise declined 5%, commercial grew 12%, public sector was up 3% and service provider declined 6%

Non-GAAP Profitability Perspective

- From a non-GAAP profitability perspective, total Q1 gross margin was 63.7%, down 1.5 points
- Product gross margin was 63.0%, down 1.8 points and service gross margin was 65.6%, down 0.6 points
- We continue to be negatively impacted by higher memory pricing like we've discussed over the past several calls, which we expect to continue in the near term
- Our operating margin was 30.4%, down 1.2 points

Acquisitions

- When we look at the impact of acquisitions on our results y-over-y, there's been a 60 basis point positive impact on revenue, no impact on gross margin, a 3 point increase on non-GAAP operating expenses, all resulting in a negative 70 basis point impact on our non-GAAP operating margin rate and a negative $0.01 y-over-y impact on our non-GAAP EPS
- In terms of the bottom line, our Q1 non-GAAP EPS was $0.61 while GAAP EPS was $0.48
  - We ended Q1 with total cash, cash equivalents and investments of $71.6B with $2.5B available in the U.S
- Q1 operating cash flow had very strong growth of 13% at $3.1B and FCF was also very strong with growth of 19% to $2.9B

Capital Allocation Perspective

- From a capital allocation perspective, we returned $3.1B to shareholders during the quarter that included $1.6B of share repurchases and $1.4B for our quarterly dividend
- To summarize, in Q1, we continued to make progress on our strategic growth priorities while maintaining rigorous discipline on profitability and cash generation
- We continued to prioritize our key investments to drive long-term profitable growth

Guidance

Definitive Agreement

- Let me reiterate our guidance for Q2 FY2018
- This guidance includes the type of forward-looking information that Marilyn referred to earlier, and also as Chuck mentioned, we announced a definitive agreement to acquire BroadSoft
- The acquisition is expected to close after completion of the customary regulatory reviews and therefore it is not included in the guidance

Revenue, Non-GAAP Operating Margin Rate and EPS

- We expect revenue growth in the range of 1% to 3% y-over-y

- We anticipate the non-GAAP gross margin rate to be in the range of 62.5% to 63.5%
- And the non-GAAP operating margin rate is expected to be in the range of 29.5% to 30.5% and the non-GAAP tax provision rate is expected to be 22%
- Non-GAAP EPS is expected to range from $0.58 to $0.60

QUESTION AND ANSWER SECTION

<Q - Pierre C. Ferragu>: Kelly, I can't help asking you an update on gross margin movement. So, can you give us a bit of a sense of how big is memory prices in the 1.5 point gross margin decline that you've seen year on year? And then sequentially, your guide for gross margin for Q2 is slightly below what you've been guiding for Q1. Is there still like incremental headwind coming from component pricing hurting you from Q1 to Q2? Thank you.

<A - Kelly A. Kramer>: Yes. Thanks, Pierre. Great question. Yes, so the vast majority of the impact on our gross margin is driven by memory. It is basically 1.3 points of my product gross margin decline y-over-y. Everything else in our gross margin is basically in the normal ranges. So we expect that to continue. When you look at the guidance, we did bring it down 0.5 point to account for that because we are still seeing increases as we look forward – moving forward, but otherwise we kind of see everything else in the normal range of things.

<Q - Mark Moskowitz>: Chuck, you talked about 1,100 customers have already adopted the intuitive network [The Network. Intuitive.]. I just want to get a sense in terms of how does that underpin longer term the steady state growth? You guys guided to about 1% to 3% growth for the current quarter but as more and more of those customers adopt and they move beyond the labs, move beyond the proof of concept, could we actually see your growth tick higher than 1% to 3% on a steady state?

<A - Charles H. Robbins>: Yes, Mark. Thanks for the question. So clearly, we're pleased with where we're going right now with this product portfolio. We're pleased with the early feedback. I'll tell you that our sales teams, our partners and our customers are very excited about the architecture that we've announced. It's still one quarter. So we have to get a little more time under our belt but what I will tell you is that when we look back at a transition like the 3850 years and years ago, it's very much in line. And I think that as more customers have the opportunity to test the automation and programmability and all of the software features that they're testing right now, we would hope that the platform continues to accelerate. So one quarter down but we feel good about where we are.

<Q - Steven Milunovich>: Yes. To continue along those lines, Chuck, you talked a little bit about the software attach rate. Could you elaborate on that? And particularly the Advantage premium, which I think has the encryption capability and so forth, exactly what sort of mix are you seeing? And do you think that customers are going be willing to pay up for the premium?

<A - Charles H. Robbins>: Well, thanks, Steve. So what I said in the script is that a vast majority of our customers that are buying these platforms are opting for the advanced and I would say that it's a vast majority. We knew when we introduced a subscription on a switch that we needed to ensure that there was unique innovation that was available to our customers in order for them to see value in that. We couldn't just simply shift the capabilities that they had gotten before in a perpetual model. We needed to drive new innovation.

So the anchors that are in that advanced subscription are the overall automation capability, which really gets at the OpEx of running these networks. And the second part is the encrypted traffic analytics where we can determine when there's malware inside encrypted traffic without decrypting it. And we think that those two are phenomenal incremental capabilities that our customers didn't have before and I think that's why we're seeing such a high attach rate. So we're very pleased with where we are on that as well.

<Q - Vijay Bhagavath>: Yes, my question for you, Chuck, and Kelly please join in is has anything changed in your sales motion in terms of data center switching? And the reason I ask is we are starting to see this positive news flow Alibaba Cloud recently and perhaps you're in Microsoft as well. What has changed in your view, Chuck, in terms of the sales motion? Is it the clouds paying attention to things like software automation, tools, security, anything else? Or is it just a sales focus on cloud? Help us understand. Thanks.

<A - Charles H. Robbins>: So, Vijay, thanks for the question. We've been talking about this for several calls now, about how we reengaged with the large web scale providers back right after I became CEO. And these are long processes as they made major architectural decisions and they have franchises that you're trying to reenter. But if you look at – whether it's the announcements we made with Microsoft a couple of quarters ago, the announcement we made with Google, you alluded to Alibaba, which there's a summary of that win on our website if you want to go see that. It's our first insertion there, and actually it was before the large sales day that they experienced I think last week. And so we continue to make progress and we're continuing to execute on what I told you that we're executing on over the last year and a half, which is trying to go deeper.

I think the other thing that has become eminently clear is that these large web scale providers realize that it is going be a multi-cloud world and they definitely have come to the conclusion that the edge is going be mission critical for our customers going forward. And as they think about that, we are very natural – we're the very natural partner for them to partner with as the network is the only common denominator across all these cloud environments all the way out to the edge of our enterprise customer's network. So we're just continuing to execute against what we set out two years ago and we hope to continue to see success.

<Q - Paul J. Silverstein>: Hey, Chuck and Kelly, I recognize you guys are no longer breaking it out but I'm hoping that you'll throw us a bone and put numbers on the data center switching revenue growth given how important it is and how strong a growth market that's been. And as part of that, Chuck, related to the previous question, can you give us any quantification of your progress with the web 2.0 hyperscale customer segment given the importance of that segment?

<A - Kelly A. Kramer>: Yes, so, Paul, yes, I mean, obviously we're trying to go to new groupings. But – and just to give you some color, I mean, we continue to see the double-digit growth that we've been talking about of our ACI portfolio continue in the strong double digits. And overall data center was certainly up from a revenue perspective.

<A - Charles H. Robbins>: And I think, Paul, from a perspective of the web scale, it's really just what I described. We're in discussions with all of them. We have made announcements with several of them. And we continue to execute against our strategy and it's – – these are large franchises. There's two facets. And if you remember on a call back two or three calls back, I said that we're now expanding our discussions into 360-degree relationship discussions. The Google announcement was reflective of that comment, because not only are we working on their infrastructure but we're also working significantly on this multi-cloud enablement, hybrid cloud enablement and helping bridge our customers, their premises-based solutions, their edge-based solutions, their cloud applications, their SaaS applications. And so we're continuing to execute on that right now.

<Q - Ittai Kidron>: And hi and congrats on a good quarter and nice to see growth on the guide. I had a couple things, first of all for you Kelly, can you update us on the number of Cisco ONE customers, just as a housekeeping?

And then for you, Chuck, getting a little bit deeper into the Infrastructure part of the business, great color there on the product lines but maybe you can help us fine tune a couple of things. One on the hyperconverged, I think Kelly actually mentioned that you were off to a good start there, but maybe you can help us understand where you stand on that product line, how good you feel about the platform, how stable it is.

And then the weakness in the enterprise routing, I'm just trying to understand how much of it is a secular issue, meaning SD-WAN starting to make an impact there vs. an execution or seasonal element. Is this going be another part of your business that's just going to be under pressure for a long time as routing has been?

<A - Charles H. Robbins>: Kelly, do you want to...?

<A - Kelly A. Kramer>: Yes, I'll just hit the Cisco ONE. Cisco ONE continues to have great momentum. We're over 22,000 customers at this point with that so still great momentum.

<A - Charles H. Robbins>: Yes, Ittai, so thanks for your comments by the way. On the hyperconverged offer, our HyperFlex offer, I would tell you that it has continued to probably be at the high end of my expectations. I'd say couple of quarters ago it began to exceed what I was expecting so I changed my expectations and it's – but they're doing a great job. The teams are doing well. I think we know the use cases where it's very competitive and I think that it continues to – they continue to operate at the high end of what I expected from them. So we're very pleased with that.

On the question relative to SD-WAN, I think you nailed it right. Our customers – and we've talked about this for a couple of calls – our customers have been trying to assess what this SD-WAN architectural transition looks like. And I think that after we acquired Viptela, we have now – at our sales meeting we provided tremendous clarity to our sales organization and our partner community at the Partner Summit about what our strategy is. We've now taken customers through the road maps of what they can expect and how to position the different alternatives that we have and how those portfolios are going to come together over the next 12 to 18 months.

So I think that it is a by-product of the SD-WAN discussion. And I would expect that we'll start to see customers move somewhat this quarter and then in H2, I think our customers will continue to begin to deploy some of these solutions. So, again, happy with where we are relative to the positioning of the different platforms.

<Q - George C. Notter>: I guess I was curious about the revenue headwind associated with the move to subscription models including Cisco ONE. Can you remind us what you wound up seeing in terms of a headwind in the October quarter? And then also what are you assuming for January? Thanks a lot.

<A - Kelly A. Kramer>: Yes, hey, George. Thanks for the question. Yes, right now we're still seeing it around that 2% range. We expect the headwind to grow once we continue to grow the intuitive network [The Network. Intuitive.] that has a subscription. As that grows, that'll grow. But right now it's in that 2% range – 1.5% to 2% range, and we expect that to be roughly in that range next quarter as well.

<Q - Tal Liani>: Yes. My question is almost a follow up to the previous question. Can you elaborate? I know you started at the beginning of the year to do the subscription on switching. Can you elaborate on, first of all, the experience you've had so far, cases where customers took the subscription vs. didn't take, what does it include? Just elaborate on the subscription and kind of the profile of it and also the take rate so far and whether you need to make any changes to it in order to improve take rates, et cetera. I'm just trying to understand the implications for future years. Thanks.

<A - Charles H. Robbins>: Yes. So, Tal, thanks for the question. Let me break it down. So the advanced subscription today is primarily being sold on the new Catalyst 9000, even though it's backwards compatible with a couple of years' worth of our – I don't know, two, three years' worth of products that we've shipped in wireless and in routing, et cetera. But what the customers are doing right now is they're basically becoming accustomed to the platform. They're testing the platform before they make an investment on any sort of backwards compatibility, is what I would tell you.

I don't think we need to make any changes right now because the attach rate of the most advanced subscription offer is at the very high end of what I would have expected. So I think we're very pleased with where it is right now. And assuming we execute on the value and the innovation that our customers continue to gain from that, then I think that we'll begin to see them then buy the subscriptions on some of their install base as well. That would be our intent.

<A - Kelly A. Kramer>: And just to add to that and just to be clear, 100% of the switches we're selling come with a subscription. It's just the difference in what additional features and security are added between the Advantage and the Essentials.

<A - Charles H. Robbins>: That's right.

<A - Kelly A. Kramer>: So 100% of the new switches are sold with a subscription and that's going well.

<Q - Mitch Steves>: I wanted to focus on the Security angle. So despite having pretty difficult comparisons last year, you're still up 8%. So could you maybe provide some color what's going well there? And then secondly, any sort of growth rates or rough numbers for the advanced threat vs. the web security growth rates?

<A - Charles H. Robbins>: Thanks, Mitch. So I think that the thing that is resonating with the customer is if you're looking at the environments that they're all beginning to operate in, they're operating in an environment where they have multiple SaaS providers, multiple cloud providers. They've got their private data centers with applications running. They've got their branch networks. They've got now edge connectivity with IoT coming in. And so, the robustness of an architecture that they have to have that protects across the network, across the endpoint, across the cloud is really what I think is differentiating it. And we've also – we've been on a multiyear journey of selling software and subscriptions against the threat intelligence and the malware intelligence that we have, and I think that's what's continuing to pay off. So I think it's resonating with our customers and it's an architecture that we continue to innovate on, we continue to expand on.

And, Kelly, any comments on the...?

<A - Kelly A. Kramer>: Yes. I mean, I'd just say advanced threat and unified threat, as well as even web security, they're all up big double digits. I mean, just really strong growth.

<Q - James E. Faucette>: I wanted to ask a question on capital structure. Can you give us an idea of what your preference is and priorities will be in capital structure in terms of buybacks and acquisitions, et cetera, if the proposed new tax changes pass vs. if that change in tax law gets derailed? I mean, particularly curious as to how you're thinking about the pacing of acquisitions vs. buybacks, et cetera? Thank you.

<A - Kelly A. Kramer>: Yes. I'll take that one. What I'd say is in terms of acquisitions, the tax policy isn't impacting us either way, because we are lucky to have a great cash flow and access to capital. So it hasn't been stopping us from anything from an acquisition perspective. And it won't, so that will continue.

I would say we're definitely encouraged by the progress that's going on on the tax reform. So like we said in the past, when that happens, and if we get a repatriation, which both plans currently have, we're going to continue like we have, growing our dividend with our earnings growth and where we have opportunity is really to get much more aggressive than we have been on the share buyback. And, of course, we want to make sure we continue to have enough fire power to continue to be able to do the right acquisitions to help us position Cisco right for the long term.

<Q - Simon M. Leopold>: I wanted to see if you could give us a little bit more insight into what you would attribute the outlook to in terms of this is Q1 with y-over-y growth we've seen in quite some time. So I'm wondering if we attribute it to an easy comparison or lapping the buildup of deferred revenue, or some specific product cycle. If you could help us assess the key elements bringing you back to y-over-y growth. Thank you.

<A - Charles H. Robbins>: Kelly, do you want to take...?

<A - Kelly A. Kramer>: Yes. Sure. I mean, I'll give you some color. I'd say it's a combination of things, right? I mean, if I go to the amount of revenue coming off the balance sheet from the progress we've been steadily making on growing our software and subscriptions, it's now up to 12% of our product revenue. It's now coming from recurring offers and off the balance sheet, so that's helping.

I would say also the launch that we had on The Intuitive. Network. and the excitement around the reinvention of the core is having an impact. So we're encouraged and you've heard me mention, we're seeing positive demand momentum in campus switching overall, which is great, and that has a big impact, because it's one of the biggest pieces of our portfolio.

So that, combined with pretty good orders like we had in Q1, gives us a very good backlog position that allows us to have a good view into what the next quarter looks like. So I'd say, overall, the overall strategy, what we've been executing and talking about for the last couple of years here is we've been making progress and all of this is benefiting us in the outlook.

<A - Charles H. Robbins>: Yes. James, just to clarify one point or just add to actually, when Kelly says 12% of our product revenue is coming from recurring offers, just to put that in perspective, when I became CEO it was 6%, so we've effectively doubled that. And I think that's certainly helpful, and just we're seeing positive feedback on the launch. So, I'm sorry that was Simon. I apologize, Simon.

<Q - Jeffrey Thomas Kvaal>: Yes. I was hoping to ask about competition in the enterprise switching space, and we've seen a little bit more out of Huawei perhaps, not in the U.S. of course but international. I'm wondering if you could put some of that color into context for us, both from them and also from some of your traditional rivals. Thank you.

<A - Charles H. Robbins>: In the enterprise switching?

<A - Kelly A. Kramer>: Yes, enterprise.

<A - Charles H. Robbins>: So, thanks for the question, Jeff. I think that if you look at some of the performance we saw around the world, to your point, in Europe and Asia we've talked about Huawei's activity over the last couple of quarters, I would say that our teams have been very focused on it. I think that the intuitive network [The Network. Intuitive.] launch that we did in June really changes the discussion. And where we compete with competitors who their value prop is up front cost of the hardware, I think we're changing the discussion, because if you look at the cost of operating this infrastructure over a five-year period, it's probably 10X the cost of the upfront hardware. So going and helping our customers really reduce that is a value proposition that helps us change the discussion relative to the competition. So they continue to be very tough but we think that competing on the price of the box upfront is something that we can shift over the next couple of years.

<Q - Erik L. Suppiger>: And it was good to see Security picking up. What are your expectations for Security growth? In the past, you've talked about driving double-digit growth on the Security side. Is that still a goal? And where do you think you are in terms of getting there?

<A - Charles H. Robbins>: Yes, Erik, thanks for that. So at our Financial Analyst Conference this summer, we articulated a long range guide in line with what you just described. We're going to have quarters that are going to vary from that but that's definitely our long-term objective. And I think our teams are focused now on what is it we need to do for the next wave of this architecture? Once we have this architecture built where we can actually defend and apply real-time defense against known threats, we can learn about a threat through malware and e-mail, and we can protect against it in the network, in the cloud, in the devices at the endpoint all at the same time. So the teams are working hard to continue to drive innovation there but also looking at what other elements can we fit into this architecture over time. And I think that's how we think about the long-term guide.

<Q - Jim Suva>: On your guidance of up 1% to 3% as you talked about earlier, it's the first time you guys have seen y-over-y revenue growth for quite a long time. Kelly and Chuck, you mentioned strength in the orders and also the subscription model taking traction. Are we now at a point where shift to subscription is no longer dragging down y-over-y comps? Or is that still a bit of a challenge and the orders that Chuck mentioned are just so much stronger? And Chuck, any end market areas we should think about for that order strength? Thank you so much.

<A - Kelly A. Kramer>: Yes, I'll take the first part. I'd say no. We're still, I'd say, growing the base of the offers faster and putting it on the balance sheet than it's coming off. But, again, both the y-over-y increase of the balance, the $5.2B was up 37% and my income statement was up 37% as well. But I'm still putting more and more offers and as we get scale through the core networking, not just on switching but the whole DNA Center, I think that'll continue to add. So it's still going be a headwind. And as I said before, this 1.5 to 2 points will move to more like a 2 to 3 points in the upcoming years as we get more scale there. So more to come but, again, we're again benefiting from – we're starting to see the benefit of just having more stability and being able to have a better line of sight and less massive fluctuations by having that.

<A - Charles H. Robbins>: And, Jim, just the market segment perspective that is probably pretty clear. We saw service provider pretty much the same as it has been for some period of time. Our largest enterprise customers, which the way we define it is really just is an organizational segment that we have. We did see – we saw negative mid single digits there, which you saw in the slides. In our commercial business, we saw 12% growth on a global basis and it was double digits in every geography, which is always good to see.

Our enterprise customers what I would tell you is that they're some of the biggest customers who take the longest amount of time to evaluate new platforms and new capabilities like The Network. Intuitive. as well as this whole SD-WAN discussion. So we're actively in those discussions with the enterprise customers. And our commercial customers tend to just move more quickly than others.

And then finally, on the public sector side, which we didn't talk about a lot, I think the big call out there I would say is that two quarters ago we talked about the pressure in the federal business. Last quarter we said we saw it improving and what I would tell you is that in this quarter we saw the year-end it seemed fairly normal. While they still have a lot of leadership roles that haven't been filled and we still have the impending December debt ceiling issue overall for this quarter we saw the federal business pretty much back to what we expected as we closed the quarter. So that's probably the commentary I could provide on the market segments.

<**A - Marilyn Mora**>: Okay. I think we are...

<**A - Charles H. Robbins**>: Well, that's it, isn't it?

<**A - Marilyn Mora**>: Yes. We are going to wrap up.

Charles H. Robbins

Q1 Highlights

Customers' Digital Business

- I just want to wrap with a few points
- First off, we are committed to executing on this vision to deliver a highly secure intelligent platform for our customers' digital business
- And we are laser focused on five key elements of that strategy to enable our customers' success and drive profitable growth for us and shareholder value as well

Intent-Based Networking Platform

- First, we are fundamentally reinventing networking with our intent-based networking platform
- We intend to further accelerate our leadership here extending intuitive technologies across the broad portfolio that we have while increasing application, visibility and automation. Secondly, security is fundamental to everything we do
- You can't build a next generation digital business without a comprehensive security strategy across endpoints, network and the cloud

Google Partnership

- Third, it is very clear that it's a multi-cloud world, and Cisco is in a unique position to help our customers navigate this by expanding our multi-cloud portfolio and extending our web scale partnerships with strategic cloud providers
- Our Google partnership is an example of the work we are doing with all of the large web scale providers

Broad Collaboration Portfolio

- Fourth, we're unlocking the power of the data with advanced analytics such as our solutions AppDynamics, encrypted traffic analytics and Talos threat intelligence
- We're also embedding AI and machine learning technologies across the breadth of our portfolio

- And lastly, we will continue to deliver a more enhanced customer and employee experience through our broad Collaboration portfolio including our intent to acquire BroadSoft.