Company Name: Cisco
Company Ticker: CSCO US
Date: 2018-05-16
Event Description: Q3 2018 Earnings Call

Market Cap: 217,559.09
Current PX: 45.16
YTD Change($): +6.86
YTD Change(%): +17.911

Bloomberg Estimates - EPS
Current Quarter: 0.689
Current Year: 2.597
Bloomberg Estimates - Sales
Current Quarter: 12731.958
Current Year: 49204.633

Q3 2018 Earnings Call

Company Participants

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

Other Participants

- James E. Faucette
- Rod Hall
- Ittai Kidron
- Vijay Bhagavath
- Pierre C. Ferragu
- Paul Silverstein
- Jeffrey Thomas Kvaal
- George C. Notter
- Srini Pajjuri
- Jim Suva
- Mitch Steves
- Tal Liani
- Mark Moskowitz

MANAGEMENT DISCUSSION SECTION

Marilyn Mora

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

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results, and will discuss product results in terms of revenue, and geographic and customer results in terms of product orders unless stated otherwise

Charles H. Robbins

Q3 Highlights

Performance

Technology, Revenue Growth, Margins and EPS

- We had another great quarter

- We are executing well against the strategy we put in place three years ago
- Our innovation pipeline has never been stronger, and we continue to transform our business to reflect the way customers want to consume our technology
- We delivered another quarter of accelerating revenue growth of 4%, solid margins, and record non-GAAP EPS up 10%
- Our performance was driven by the acceleration of our intent-based networking portfolio, continuing strong customer demand for our innovative solutions, and the increasing value of the network
- We also made steady progress in shifting more of our business towards software and subscriptions
  - This resulted in broad-based strength across our products and geographies

Customers

Network, SaaS Applications and Portfolio

- As I've talked with customers around the world, it is clear that the network is playing an increasingly critical role in helping them manage their complex environments
- They are consuming services for multiple cloud providers, multiple SaaS applications, connecting billions of new devices which are generating massive amounts of data, and the network is pervasive across all of these environments
- We have been evolving our portfolio to help our customers deal with this complexity and provide unprecedented simplicity, visibility and security across on-premise, hybrid and multi-cloud environments

Infrastructure Platforms

- Now, I'd like to review our momentum across key priority areas and share some of the innovations we're driving across our portfolio

Intent-Based Networking and Catalyst 9000

- First, let's start with Infrastructure Platforms
- We are leading the network industry's transformation to intent-based networking across the campus, branch, data center and the edge
- We are paving the way to help customers simplify and manage the network
  - Only Cisco offers an end-to-end, intent-based networking portfolio that delivers assurance, industry-leading security, policy-based automation and segmentation
- We continue to see very strong adoption of the Catalyst 9000, the fastest ramping new product introduction in our history
  - This includes another quarter of high uptake of our advanced subscription offer and DNA center, our automation and analytics platform

Customers and Networking Innovations

- The Catalyst 9000 now has over 5,800 customers, up from 3,100 last quarter

- This is an excellent example of how we've begun to scale our Enterprise Networking business into a subscription model
- We've also recently introduced additional intent-based networking innovations
  - These include new access solutions and routing software subscriptions, which expand our software-defined WAN capabilities onto any platform

ACI SDN Solution and New Hybrid Cloud

- We are extending our leadership in data center and cloud by providing highly-secure and differentiated offerings such as our ACI SDN solution
  - With growing 100 gig deployments, especially in cloud infrastructure, we remain well-positioned for future growth with our data center switching and intent-based portfolio
- We also announced new hybrid cloud workload management solutions with ACI multi-site management and new flexible consumption models including SaaS delivery for our Tetration platform
- Whether deploying Enterprise applications or containers in a multi-cloud environment, customers are increasingly turning to Cisco's unique architectural approach
  - This is leading to strong momentum with UCS, our compute platform, and HyperFlex, our hyper-converged offering, as customers benefit from simplicity and scalability to support their hybrid cloud strategies

Security

Architecture

- Now, turning to Security, which is foundational to everything we do
- Our architecture delivers highly effective security from the network to the endpoint to the cloud
  - This unique ability to bring together networking and security at scale gives us a huge competitive advantage
- With the largest customer base in enterprise security, it is clear that our strategy is working
- The strength we saw in the quarter is driven by our integrated architecture combined with best-of-breed products
  - We are also leveraging artificial intelligence and machine learning to reduce time to detection and remediation

Talos Intelligence Platform

- A great example of this is our Talos intelligence platform, where we block 20B threats every day
- We continue to rapidly innovate in security to address key areas of concern for our customers such as security in their complex data centers
  - We introduced a comprehensive integrated data center security architecture that is designed to protect the modern data center by seamlessly following any workload anywhere across physical and multi-cloud environments

Applications

Spark & WebEx Platforms and Acquisition

- Now, moving to applications, this quarter we introduced new innovations across our collaboration portfolio with the convergence of the Cisco Spark and WebEx platforms combined with new WebEx Meetings and WebEx Teams applications
- We further enhanced our AI and machine learning capabilities across our collaboration portfolio with the acquisition of Accompany, a relationship intelligence platform with robust insights and intelligence to improve meeting and team experiences
- We completed this acquisition last week

Strategy

- We are pleased with the consistent progress we've made to deliver on the strategy we put in place nearly three years ago
- We have solid business momentum
- We are confident in our pipeline of innovation and future growth opportunities, and our commitment to driving value for our shareholders remains as strong as ever
  - This is clearly demonstrated by the fact that we delivered record capital returns this quarter

Innovation and Achievements

- As part of our commitment to shareholders, we are also very focused on our responsibility as a company to drive impact within our communities through innovation and active engagement
- It is not only the right thing to do, but a key requirement for long-term business success
- We are deeply committed to our longstanding efforts around sustainability, education, and disaster relief, as well as other key issues such as hunger and homelessness
  - I could not be prouder of our achievements or more excited about the impact we will have going forward

Kelly A. Kramer

Financial Highlights

I'll start with a summary of our financial results for the quarter, followed by the guidance for Q4

Revenues and EPS

- We were pleased with the financial performance in Q3 with broad strength across the business
- We executed well with very good orders momentum, strong revenue growth, and solid margins
- Total revenue was $12.5B, up 4%, and non-GAAP EPS was $0.66, up 10%

- We continue to focus on driving margins and profitability with a strong non-GAAP operating margin rate of 31.5%

Product Revenues and Growth

- Let me provide some more detail on our Q3 revenue
- Total product revenue was up 5%, demonstrating the strength of our portfolio
- Infrastructure Platforms grew 2%, with strength in all businesses with the exception of routing
- Switching returned to growth with revenue growth in both data center and campus
- Campus growth was driven by our new switch, the Catalyst 9000
- We saw solid growth in wireless with strength in Meraki and our Wave 2 offerings
- Data center had very strong double-digit growth, driven by servers as well as HyperFlex
  - Routing declined largely with the continued weakness in service provider

Applications, Security, Deferred and Service Revenues

- Applications was up 19% in total, with broad strength across the businesses
- We saw very solid growth in TelePresence endpoints, UC infrastructure, and AppDynamics
- Security was up 11% with strong performance in unified threat, advanced threat, and web security
- Deferred revenue grew 38%, as we continued to drive more subscription-based software offers
- Service revenue was up 3%, driven by growth in advanced services as well as software and solution support

Revenue from Subscriptions and Deferred Revenues

- We continue to transform our business, delivering more software offerings and driving more subscriptions and recurring revenues
- In Q3, we generated 32% of our total revenue from recurring offers, an increase of 2 points from a year ago
- Revenue from subscriptions was 55% of our software revenue
- We drove good growth in deferred revenue, which was up 9% in total, with product up 18% and services up 4%
- Deferred product revenue from our recurring software and subscription offers was $5.6B, up 29%
  - We saw strong momentum in Q3 product orders, growing 4% in total

Geographies and Customer Segments

- Looking at our geographies, Americas grew 4%, EMEA was up 6%, and APJC was up 3%
- Total emerging markets was up 7%, with the BRICs plus Mexico up 12%
- In our customer segments, Enterprise was up 11%, Commercial grew 7%, Public Sector was up 2%, and Service Provider declined 4%

Gross Margins and Acquisitions

- From a non-GAAP profitability perspective, total Q3 gross margin was 63.9%, down 0.5 points
- Product gross margin was 62.9%, down 0.3 points, and service gross margin was 66.9%, down 0.9 points
- We continue to be negatively impacted by the higher memory pricing we have discussed over the past several calls, which we expect to continue in the near term
- Our operating margin was strong at 31.5%
- When we look at the impact of acquisitions on our results y-over-y, there has been 120 basis point positive impact on revenue and a negative $0.01 y-over-y impact on our non-GAAP EPS.

Net Income and EPS

- In terms of the bottom line, non-GAAP net income of $3.2B was up 6%, while GAAP net income was $2.7B.
- We grew non-GAAP EPS 10% to $0.66, while GAAP EPS was $0.56

Cash Flow, Foreign Taxes, Cash and Investments

- We delivered operating cash flow of $2.4B, down 28%
- We paid $1.3B of one-time foreign taxes during the quarter related to the Tax Cuts and Jobs Act
- Operating cash flow increased 11% normalized for these tax payments
- We repatriated $67B of our offshore funds to the U.S. and ended Q3 with total cash, cash equivalents, and investments of $54.4B, with $47.5B available in the U.S.

Share Repurchasing and Dividend

- From a capital allocation perspective, we returned $7.6B to shareholders during the quarter that included $6B of share repurchases and $1.6B for our quarterly dividend

Video Software Solutions business

- We recently announced an agreement to sell our Service Provider Video Software Solutions business
- We expect this transaction to close in Q1 FY2019, subject to any regulatory approvals and customary closing conditions
  - We are continually looking to optimize our portfolio

Summary

- To summarize, Q3 was a good quarter with solid top line growth, strong profitability and order growth
- We continue to make solid progress on our strategic priorities, making key investments to drive our long-term growth

Guidance

Revenues, Gross Margin Rate, Tax Rate and EPS

- Let me reiterate our guidance for Q4 FY2018
- This guidance includes the type of forward-looking information that Marilyn referred to earlier
- We expect revenue growth to be in the range of 4% to 6% y-over-y
- We anticipate the non-GAAP gross margin rate to be in the range of 63% to 64%
- 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 21%
- Non-GAAP EPS is expected to range from $0.68 to $0.70

QUESTION AND ANSWER SECTION

<Q - James E. Faucette>: I wanted to ask, as you – one of the key things that investors are looking at is the continued growth in subscriptions, et cetera, and it seems like the deferred continues to grow nicely. One of the key questions that we have though is, as you continue to show good demand for the new Catalyst 9000 products and distribution expands, what are you seeing in terms of attach rates for subscriptions to that new product? Are they maintaining the levels that you'd seen at the early stages of launch, or they're starting to normalize back to more traditional levels? Just trying to get a little color on how well that time strategy is working for you. Thank you.

<A - Charles H. Robbins>: I would say it's been very consistent over the last four quarters, I think, since we've put it in the marketplace in Q4 of last FY. I think we had one month of activity, so it's been incredibly consistent. We're really pleased with the acceptance of this product.

I think adding 2,700 more customers in the quarter, if you think about that, that means we added over 40 customers per day that acquired the Catalyst 9000 for the first time. And the acquisition of that product, in my opinion, is a clear belief in the next-generation architecture with the automation platform that we're announcing, which is what the advanced subscription model requires. And so I think that's reflected in the continued high uptake that we see on the advanced subscription. Kelly?

<A - Kelly A. Kramer>: Vast majority is the advantage, which has the advanced features and the higher margin profile. And then, the only other thing I would add is it is very evenly spread across commercial enterprise and public sector in terms of the demand and where we're seeing all the business.

<Q - Rod Hall>: I just wanted to try to dig under the covers a little bit on the revenue guidance. Obviously, Service Provider was weak and sounds like routing is weak, in line with that. Just wondering if you could, Kelly, maybe give us any idea how much Service Provider Video is affecting that guide and also the routing within that guide, like, what are you assuming there? Are you assuming routing continues to kind of drive that growth down? And then, I have a follow-up.

<A - Kelly A. Kramer>: In general, I think the trends on both routing and Service Provider Video, which is in the other bucket, have been consistent, and we're not assuming any improvement in either of those. So, I would say our guide includes what we see. We feel really good about the rest of portfolio actually, and we see very good growth there, but those two trends are not improving. So, that's basically what I have included.

<Q - Rod Hall>: Could you also comment on OpEx to sales that's picking up a little bit, and the guide at least implied? And I'm wondering if you could maybe give us any color on what's moving around in OpEx for fiscal Q4?

<A - Kelly A. Kramer>: On OpEx, it's mainly driven by – the increase is mainly driven by the acquisitions we brought in, specifically AppDynamics. As you know, when we bought AppDynamics, very early stage, we're in heavy investment phase with them. So, that's part of it, as well as we've consolidated now Broadsoft and that also has a fairly high OpEx impact.

If I back out, if you look at my OpEx growth for the quarter, which was up a little less than 6%, 4 points of that alone is just purely the acquisitions. And that's, as I mentioned, the impact of acquisitions on my top line and it's hurting me on EPS. It's mainly in the OpEx line, so that's what's driving that. We're being very disciplined within the rest of the business to managing the portfolio. So, I think it will continue kind of in that range as we look forward to Q4, but that's kind of the underlying driver.

<Q - Ittai Kidron>: Had a couple of questions. First, on the Catalyst 9000, good progress, but help us understand how big is your Catalyst installed base from a customer standpoint. What percent of it do you really think the Catalyst 9000 is relevant to? Because it's hard to gauge whether you're moving too slow or too fast. Forty customers a day, it sounds like a lot, but maybe for a company like Cisco, it's not fast enough. So, help me understand how do you think about driving that throughout your installed base, especially with now Arista potentially coming to the marketplace.

And then, second question. I had a question about China. Clearly, relations there have not been on the good side recently, and you've been somewhat a little bit more optimistic on that country over the last year. What are you seeing out of there? And how do you take that into your outlook commentary?

<A - Charles H. Robbins>: First of all, thanks, Ittai, and thanks for the positive comments. On the Catalyst 9000, I think that we have roughly 840,000 customers, and I would say that there's a very long list of customers that are still available to us to deliver this platform. If you look at the products that we have put in the market in the new Catalyst 9000 family are sort of like if you stack our portfolio and you say we have a very low end switch and then you have the old Catalyst 3000, the old Catalyst 4000, those are kind of the platforms that the current Catalyst 9000 family replace. So, there's still a very long tail of customers.

The other thing you have to remember is many of these customers are buying the Catalyst 9000, and then it will become the standard platform and they'll refresh the balance of their networks. The other thing I'll point out is that I think we said on one of the calls a while back that the Enterprise segment, we would expect to lag the Commercial segment with the Catalyst 9000. And we did, in fact, see the Enterprise business improve and the Catalyst 9000 was part of that.

So, I think we still feel good about it. And this architecture has a long future for us, and there's a portfolio of products that fit within it. So, I think if we're really honest, the number of customers who are making the decision to upgrade to the Catalyst 9000, I would say it's not necessarily because, wow, what a fantastic new Ethernet switch. It's really because they're buying into this automation strategy, of which the entire portfolio will fit over time. And I think that's what we're banking on, and that we're banking on the long-term success.

So, the China question, if you look at our China businesses this quarter, we actually saw strength in switching in both the Enterprise and Commercial segments. And overall, I think there's still uncertainty there. But I believe – and I have been optimistic and I remain optimistic – that the two countries will come to some closure on the trade issues and that we'll get stability there. And I think we still believe in it. It's going to be, obviously, the largest economy in the world in the coming decade, and we remain committed. And actually we're doing pretty well. If you look at the SP routing business in China, it continues to be stressed like it is around the world, but much of the other portfolio elements, we're very pleased with.

<Q - Vijay Bhagavath>: These are solid results here. You beat on all major categories. A quick question for you, a bigger picture question actually, Chuck and Kelly as well, which is, as your software subscriptions attach rate sees strength, could we see the sales OpEx, for example, start to trend down? Are you already seeing that impact to your sales OpEx line?

And then, just a quick practical question in terms of approximately what was the run rate of the SP Video business you sold to Permira? Because that would help us to inflate your July quarter guidance if it wasn't sold [indiscernible] (22:30) business. Thank you.

<A - Charles H. Robbins>: Let me give some color around how we see the sales model evolving, and then I'll let Kelly answer the financial side of those questions for you. Vijay, I think what you're going to see is that we're actually building a traditional -I'll say a traditional software model where we have a customer success organization that, over time, will take on more responsibility for all of the functions in a software company, the whole adoption, expansion, and particularly the renewal space, which will allow us to renew a lot of these offers over time.

It's a multiyear renewal window, but renewing over time at a much lower cost of sale, I would suggest that that may give us either some obviously operating leverage or it may give us the ability to invest in more R&D or other areas. But that's the model. That's one of the key reasons that we brought in Maria Martinez, who is now our Chief Customer Experience Officer, who is helping us build out that capability, who has a long experience of doing that in several software companies. So that is one of the major efforts that we have underway right now, to not only increase our ability and our rates of renewal, but also to do that at a much different cost structure going forward. Kelly?

<A - Kelly A. Kramer>: And just on the SPVSS business, we will – it is in my guidance right now because we're going to – obviously we continue to run this business until the deal closes. It is the majority of what's in the other bucket, Vijay, so it's the bulk of that, but like we did when we divested the set-top box business, once we close a transaction, we'll give you all the history so we can adjust the models and go forward from there. So you'll have complete visibility all the way through the P&L once we close the transaction.

<Q - Pierre C. Ferragu>: On the gross margin, do you still suffer from these DRAM prices? Has it improved or has the pressure increased sequentially compared to last quarter? And then we've had this pricing for some time now in the market, and I was wondering. How are you going to reflect that in your pricing strategy, and when should we expect you to start passing on these extra costs to your client?

And then lastly on the gross margin. I assume that you're still increasing very fast the share of software and subscription services in your revenue mix, so it should have a positive impact on gross margin. If you can comment on that as well, that would be great. Thank you.

<A - Kelly A. Kramer>: First, on the memory, so yes, memory is still hurting us y-over-y. In my product gross margin, it hurt us to the tune of about 60BPS y-over-y, so more than what we were down y-over-y. It is marginally less bad than it was last quarter, which was marginally less bad than it was a quarter before then. So the slope of the increases are getting less, though it's still increasing y-over-y, so it's about 60BPS.

I would say in terms of pricing, we had another very, very good quarter for price. We always have price erosion, but like you saw last quarter, our price erosion was at the very low end of what we've seen over the last three years, and that continues. And a part of that reason of why that continues is we have been passing on the memory DRAM cost increases through price increases on our servers like we have been as well as a lot of our peers, as well as our product managers in other parts of the portfolio have been really been very disciplined about looking at where we have some price elasticity, and have been selectively and surgically looking for areas that we could take advantage of price elasticity. So I feel really good about where our price index was this quarter, much in line with where it was last quarter.

And then to your third point, on the software being a benefit, that is true, though I will say a portion of that is getting offset now that we're ramping the Catalyst 9000 so quickly. And as you know, a portion of that gets deferred because it's a subscription. That has a negative impact on our rate as well. So, this quarter it was about 30BPS alone just for the Catalyst 9000 alone, now becoming bigger in the revenue contribution and impact on our rate.

So, again, the three things are 60BPS on memory, 30BPS on the Catalyst 9000 impact, and then we had pretty strong price and some favorable mix coming through from software.

The only other last point I will make, we had a very, very strong quarter on our UCS, our Server business, and that has a little bit of negative mix for us as well. Okay?

<Q - Paul Silverstein>: Against my better judgment, I'm to ask you a wide-open question, which is for either or both of you, Chuck and Kelly. What are you most excited about in terms of upside opportunity, whether revenue or margin? And what are you most concerned about in terms of downside risk?

<A - Charles H. Robbins>: I think that what I am most optimistic about is the renewed innovation that we have brought and will continue to bring in our Enterprise portfolio, particularly into our core franchises which was one of the things that when I spoke to many of you when I became CEO three years ago and even when we were on the road last year, I said the number one priority for us right now and it – obviously, we're going to continue the business model evolution, but the number one priority was to get the Enterprise portfolio and particularly the switching business stabilized, which our teams have done a great job.

And even if you look at the Security portfolio with the team, and then I will tell you on the Enterprise routing space, Kelly talked a little bit about the overall routing business, but SP routing is about half. And the Enterprise routing, I will tell you that our teams have been working hard on the integration with the Viptela acquisition into our Enterprise routing portfolio. And I actually feel really good about how that's coming along, and I'm optimistic about where that goes in the future, and I'm very optimistic about the overall innovation within the intent-based networking portfolio that we're going to bring forward over next months, quarters and years.

I guess if I had to say, what I would be most concerned about in general, it's just sort of the macro and/or some geopolitical risks. I mean, you've got – you've obviously got lots of trade discussions, which I remain optimistic on, but as long as there's uncertainty, then we wait and see. Obviously, the dollar rising. While we had a good quarter in emerging countries and we're pleased with our execution there, the rising dollar obviously is another macro issue. But I'm very pleased with what the teams are executing on right now, and that's how I'd leave it.

<Q - Jeffrey Thomas Kvaal>: You spoke about your progress in the data center switching side of things. I'm wondering if you could help us understand how things are going in the Enterprise data center market and how your relationships are progressing in the webscale data center market – or just webscale in general would be helpful to us outside of data center switching. Thank you.

<A - Charles H. Robbins>: I'm very happy with what our teams are doing in the data center switching market in general. I think that the 100 gig transition, we're pleased with the return to growth in both the data center and the campus from a switching perspective.

On the webscale side, I would say the story continues to remain as I've articulated it. We continue to make progress. You've seen the announcement we made, obviously, with Google. We continue to work and execute on the details of those solutions that we announced with them. You'll see more coming out later this year from us there.

We continue to engage deeply with all of these players. We've had continued progress with several of them and continued favorable discussions, but these are, as I've said repeatedly, some of these are multi-year architectural decisions and they take a while. But again, I'm optimistic and pleased with where we are right now.

And I think the other thing I'd point out is that this environment that our Enterprise customers are facing right now where literally four or five years ago, they thought they were going to move to the public cloud and have a much simpler IT world, they now find themselves with three or four public cloud providers that they're consuming services from. They have 50, 60, 100 SaaS providers. We're beginning to see this real explosion of IoT devices at the edge. They still have their private data centers. Those have not gone away. You've got all of the mobility and customers and suppliers, and so the network is so fundamental to making all that work. And the webscale providers know that as well, which has really enabled us to build these broad relationships that extend well beyond just the data center. So, we're still pleased with where we are, and we have a long way to go.

<Q - George C. Notter>: I wanted to circle back to a conversation from prior earnings calls. You guys had talked about the revenue headwind associated with the move to more subscription-oriented models. And Kelly, I'm wondering if you can give us an update there. Is that still a headwind this quarter, and how do you see that progressing going forward? Thanks.

<A - Kelly A. Kramer>: The headwind is still there because we are very much increasing the number of offers that we have, as well as the revenue dollars that we're putting on the balance sheet. So, the headwind is increasing. And just as we had talked in the past, now that the Enterprise portfolio with the Catalyst 9000 is starting to hit revenue, the headwind's increasing. So, we've said in the past it was 1.5 points to 2 points. It definitely now is approaching the 2 points to 2.5 points. And as we ramp more and more of the portfolio, we'll continue to see that.

<Q - Srini Pajjuri>: My question is on the recurring revenue. It dipped a little bit to 32%. If you could give some color on that. And also, I think your target long-term is exceeding 37% in FY2020. Is that primarily a function of Catalyst 9000 ramping in volume, or are there any other products that could contribute to that? And also, I'm wondering if you need to expand the subscription model to other products to achieve that goal.

<A - Kelly A. Kramer>: On the recurring revenue, it's basically in the rounds. If I look at our product recurring revenue again, it continues to grow over 30% to over 13% of our total product revenue. And, overall, total recurring revenue is again growing in the double digits. So, it's really the math and a little bit of the mix now that we have product revenue growing so much faster than services. That's driving kind of just the pure math of the rounds from 33% to 32%, but we feel great about how it's progressing.

Yeah. If you go to our Financial Analyst Conference, we feel we're right on track of what we projected as that goes out to FY2020. The only caveat I'll give you on that is when we go into our FY2019, we have to adopt the new revenue standards, which will have some implication on some of the products that are included in this. So, we plan to have a call where we can go through the anticipated area that will be impacted to give you guys more clarity. And then, we'll adopt that day one of our FY2019. But, overall, we feel great about the traction, we're executing very well, and we're on track, if not slightly ahead, of what we expected when we talked at the Financial Analyst Conference.

<A - Charles H. Robbins>: Just one last comment on the part of your question where you asked if we would need to extend this to other parts of our portfolio. I mean, we will. If you look at the new Enterprise routing, some of the comments I made in my opening was that we're extending our software and subscription business in the routing space. Many of those are software solutions, so we'll continue to evolve. And frankly, it's driven by how our customers want to consume the technology, which is great. And as Kelly said, it will create a short-term headwind. But we think, long term for the business, it's absolutely the right thing to do.

<Q - Jim Suva>: I have a brief question for Chuck, and then, Kelly, more of a clarification one. But, Chuck, there wasn't any mention yet, at least on the Q&A, about competitors going into the campus side of things with Arista making an announcement. How do you look at that? I know competition isn't anything new, but do you need to step up your sales efforts, or how should we think about that?

And then, Kelly, for the CFO question, how should we think about – you've got time now to think about the tax law, sort through all the changes. Is your outlook 21% outlook long term? And stock cadence, you did a lot more stock buyback this quarter than normal with your new announcement. How should we think about those financial metrics? Thank you so much.

<A - Charles H. Robbins>: Let me hit the first one. Relative to the competition in the campus, what I would say is look, we launched this architecture last June, and I think our customers have been incredibly excited about it. One of the very important things that we did is we made the architecture and DNA center backwards compatible with at least one generation of our wireless products, our switching products, our routing products, et cetera.

And I think that taking a look at all of those products is incredibly important because our customers don't want to have an automation platform that handles switching. They want an automation platform that handles the enterprise, at a minimum, the enterprise network. And then, over time, as we integrate our automation platform in the data center and the campus, you'll be looking at the ability to automate from the data center to the campus to the wireless network to the routing, and frankly the security architecture. And we think that is a unique architecture that we can deliver. We are leading right now. We see incredible acceleration of the Catalyst 9000 in adoption by our customers, and we're very comfortable with where we are in this transition.

<A - Kelly A. Kramer>: And on the tax question, so again, we feel really good about where we stand in terms of that. As we said in the call, we brought back $67B from overseas. And like we said in last quarter's earnings, we announced a big increase to our share buyback authorization. So we have $25B remaining in our share buyback, and we anticipate using that in the next basically 18 to 21 months. So we're being very aggressive there, like we had stated we would be once we got our cash back. So that's going well.

As far as the tax rate, we also stated in Q2 that we expect our tax rate to be in the 21% for FY2018, and we expect it to go down to 20% in FY2019 when we get the full benefit of the new U.S. federal rate. So overall, we feel great about the tax law and the implications for us.

<Q - Mitch Steves>: I actually wanted to circle back a little bit and poke at the recurring revenue piece. I have it at 32%, and you're noting that you got 120BPS from acquisitions. Can you help me understand what really drove the decline Q-over-Q from 33% to 32%, given that the acquisitions you guys have done have been software in nature?

<A - Kelly A. Kramer>: Basically AppDynamics has been in the numbers as we go along. I would say Broadsoft has a mix of both perpetual and recurring, so it is not all recurring.

I would say the bigger impact on the numbers – and again, it's really just the mix of the products. When we have product revenue growing 5%, services growing 3%, and within that product number we had very, very strong server revenue growth, which has a very low software recurring proponent of it, that's what's really driving it. As I said, overall, the growth of product recurring revenue was over 30%, like it has been for the last five quarters, so that just continues to grow. It's really more the denominator of total revenue that's driving just the slight round down to 32%.

<Q - Tal Liani>: Security was up 11%, which is an acceleration from the previous two quarters. Can you talk about what went right and what went wrong with Security this quarter? And what are the things that are driving this acceleration? Thanks.

<A - Charles H. Robbins>: We remain confident in the Security architecture that we built even when we had some deviation in the revenue run rate over the last year. And I think that as you look at the architecture that we have, which extends from e-mail to endpoints to the network to the cloud and then has this massive state machine where we can correlate threats and then dynamically defend, it's a unique proposition. And we say that we have this integrated architecture, but also best-of-breed products. So, where we are convincing customers that the architecture is right, then we're winning. And I think that our teams are doing a really good job. I think that the engineering teams have continued to add new features and new capabilities that our customers are adopting, and I think it's as simple as that. It's just we have reasonably good traction in the field right now.

<Q - Tal Liani>: And can you share with us maybe the areas where you think you need to strengthen your portfolio?

<A - Charles H. Robbins>: We have – the great thing about this architecture when we build it is that you can continue to add virtually any source of threat intelligence to this because it's built to digest massive amounts. I mean, we see 20B threats every day. So, you can assume that we can add any sort of capability that we like that includes threat sources and, frankly, the same thing from a defense perspective. So, within the portfolio, I think there's always an opportunity for our teams to continue to improve and continue to add features. And there's a lot of good competition in this space. It's very fragmented, so we just continue to execute against delivering that architecture.

<Q - Mark Moskowitz>: Just one more revenue question for me. Kelly and Chuck, how should we think about H2 calendar 2018 relative to your fourth quarter revenue guidance in terms of the 4% to 6% goalpost y-over-y? Is there any inflection point with respect to the selling cycle? We've heard anecdotally from some of our checks that it is a slightly longer selling cycle as customers try to understand more the subscription element. And as they do become more receptive, could you actually see accelerated revenue growth maybe closer to that 6% or better as you go into the October-January quarters? Thank you.

<A - Kelly A. Kramer>: As you guys know, we really do just give guidance one quarter in advance, and we feel very good about the guidance we gave, the 4%-to-6% growth. As we look forward though, just to give you some color context, in the Catalyst 9000, the demand is great. We have fantastic demand. We are taking orders like crazy, and there's great adoption out there by our customers that we don't see slowing down, so we feel great about that. But, again, there's a lot of moving parts, and we'll take it one quarter at a time.

The only other thing I just want to remind you is we do have – when our FY starts in August for 2019, we do have the tweak on the new revenue standards that will take you through any implications of. So, feel really good about Q4 guide, and we're just going to take it one quarter at a time.