Company Name: Cisco
Company Ticker: CSCO US
Date: 2018-08-15
Event Description: Q4 2018 Earnings Call

Market Cap: 206,268.43
Current PX: 43.86
YTD Change($): +5.56
YTD Change(%): +14.517

Bloomberg Estimates - EPS
Current Quarter: 0.708
Current Year: 2.947
Bloomberg Estimates - Sales
Current Quarter: 12755.273
Current Year: 51156.321

Q4 2018 Earnings Call

Company Participants

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

Other Participants

- Vijay Bhagavath
- Rod Hall
- Ittai Kidron
- Pierre C. Ferragu
- Sami Badri
- Samik X. Chatterjee
- Paul Silverstein
- James E. Fish
- Simon M. Leopold
- Jim Suva
- Tal Liani
- George C. Notter

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

Q4 Highlights

Revenues and EPS

- We had a very strong finish to a great year
- We generated our highest quarterly revenue of $12.8B and non-GAAP EPS of $0.70 as growth accelerated for another consecutive quarter

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- Our momentum was broad-based across our portfolio, customer segments, and geographies
- We also continued to generate solid margins, cash flow, and returns for our shareholders

Customer Adoption

Pipeline of Innovation

- Our results demonstrate a combination of strong customer adoption of our latest innovations, the ongoing value customers see in our software and subscription offerings, and excellent execution across our customer segments and geographies
- Our strategy is working and we believe that we are well-positioned to capture growth across the portfolio with our pipeline of innovation

Multi-Cloud Environments and Duo Security

- The broad adoption of multi-cloud environments is changing the very nature of how modern IT infrastructures are built and secured, and Cisco is at the center of this transition
  - The recently announced intent to acquire Duo Security is another example of how we are extending our intent-based networking portfolio for the multi-cloud world

Duo's SaaS

- Duo's SaaS-delivered solution will expand our cloud security capabilities to help enable any user on any device to securely connect to any application on any network
- Combining Cisco's network, endpoint, and cloud security platform with Duo's zero-trust authentication and access solutions, we will be able to further enhance the industry's broadest and most effective security architecture in the market

Infrastructure Platforms

- Now, I'll briefly highlight some of our innovation and the great momentum we're seeing across our key product areas, starting with Infrastructure Platforms
- We continue to rapidly innovate and transform our technology portfolio to drive even greater customer value
- A year ago, we reinvented the enterprise networking with the launch of our intent-based networking architecture
- This quarter, we saw a continued strength in Infrastructure Platforms driven by the Catalyst 9000 as customers look to us to simplify and automate their networks
  - Over the last year, we introduced additional innovations across our networking portfolio, including new access, WAN, and data center offerings
- In June, we announced new developer capabilities across our intent-based networking portfolio spanning all network domains: campus switching, wireless, WAN, data center, and cloud

Developer Program

- We're also excited that our developer program, DevNet, surpassed 500,000 registered members

- As part of this program, we introduced new offerings to help developers and network engineers innovate throughout our intent-based architecture
  - As we all know, the WAN is undergoing an architectural transition to a software-defined WAN to enable IT to rapidly respond to changing business needs in a digital and cloud world
- Our customers are driving this transition and looking to Cisco to help them make this shift

SD-WAN Portfolio Leverages

Networking Products and Viptela

- Our SD-WAN portfolio leverages our leading networking products, automation, and robust security architecture to enable greater flexibility, increased bandwidth, and lower costs
- This quarter, we saw significant traction with Viptela as it has now been deployed at over 800 customers, driven by our ability to provide higher capacity at a lower cost
  - We are pleased with the ongoing integration of Viptela, with our core portfolio to drive even more value for our customers

Multi-Cloud Environment

- As our customers move to a multi-cloud environment, we see tremendous opportunities to provide value to them by redesigning their IT architecture, delivering security and building, orchestrating, and managing applications
- In Q4, we saw the production launch of our hybrid cloud solution with Google, the introduction of a multi-cloud solution with NetApp, and numerous engagements with customers redesigning their IT architectures
  - We continue to believe Cisco is very well-positioned to benefit from the increasing adoption of multi-cloud

Security

- Turning to Security, security continues to be our customer's number one concern and it is a top priority for us
- Our strategy is to simplify and increase security efficacy through an architectural approach with products that work together and share analytics and actionable threat intelligence

Talos, Network and Enterprise Security

- This architecture is supported by Talos, one of the largest commercial threat intelligence teams in the world
  - We identify and protect against new and emerging threats like the recent VPNFilter vulnerability through our sophisticated infrastructure and unrivaled telemetry of data
- Cisco is the largest network and enterprise security company and our approach of bringing security into the intent-based architecture and offering security across the network, endpoint, and cloud has proven to be very successful
  - This quarter, we saw a continued strong momentum, with revenue again accelerating and growing double-digits y-over-y

Investment

- We continue to invest in our product and technology innovation as we are committed to helping our customers on their multi-cloud journey
- Our focus is on delivering cloud security solutions that provide ease of use, scalability, and protect end users
- As I mentioned earlier, with our acquisition of Duo Security, we will further enhance how we deliver simple, automated, trusted access anywhere for our customers' environments

Applications

Webex

- Moving to Applications, in May, we announced the launch of Webex Teams, bringing together Meetings, Calling, and teamwork into an integrated experience as part of the Webex platform
- In Q4, we introduced major new enhancements to the platform, including a new user design for Webex Meetings and a new solution with Google, combining their Contact Center AI service with the Webex platform
  - With more than 3mm customer service agents globally using Cisco's Contact Center software, our integration with Google will help to automate responses in our call centers by leveraging data and intelligence from AI.
- We also achieved another robust quarter of growth with AppDynamics, underscoring the importance and value of our unique end-to-end visibility and analytics from the end user to the network to the application

Summary

- To wrap up, 2018 was a great year
- We returned to growth, invested in our core franchises, delivered new innovative platforms, and continued to shift our business to more software and subscriptions
- Our record results demonstrate the strength of our business as well as the strategic focus and execution that we have delivered over the past 12 months
  - I want to thank our teams around the globe for delivering these results

Outlook

Growth, Execution and Innovation

- We are looking forward to FY2019 with a clear focus on growth, execution, and innovation
- We see incredible opportunities across our business and believe we are uniquely positioned to deliver on our vision to be one of the most strategic partners to our customers as they go through their digital transformation

Kelly A. Kramer

Financial Highlights

Orders, Margins, EPS and Net Income

- I'll start with a summary of our financial results for the quarter then cover the full FY and Q1 outlook
- Q4 was a solid quarter across the business
- We executed well with strong orders, revenue growth, margins, EPS, and operating cash flow
- It was great to see accelerated momentum in product orders which grew 7%
- Total revenue was $12.8B, up 6%
- Our non-GAAP operating margin rate was 30.9%
- Non-GAAP net income was $3.3B, up 8%, and non-GAAP EPS was $0.70, up 15%

Q4 Revenues and Growth

Product Revenues and Infrastructure Platforms

- Let me provide some more detail on our Q4 revenue
- Total product revenue was up 7% with broad strength across the portfolio
- Infrastructure Platforms grew 7%, with growth in all businesses except for routing which was down slightly

Switching, Data Center, Routing, Applications and Service Revenues

- Switching had another great quarter with strong growth in campus driven by the ramp of the Cat 9000 and growth in data center driven by the Nexus 9000
- We saw good growth in wireless with strength in Meraki and our Wave 2 offerings
- Data center had very strong double-digit growth driven by servers and HyperFlex
- Routing declined slightly driven by weakness in SP Routing
- Applications was up 10% in total with growth across all the businesses
- We saw very solid growth in Unified Communications, TelePresence, Conferencing, and AppDynamics
- Security was up 12%, with strong performance in network security, unified threat, policy and access and web security
- Service revenue was up 3%, driven by growth in Advanced Services as well as Software and Solution Support

Subscriptions and Recurring Revenues

- We continue to transform our business, delivering more software offerings and driving more subscriptions and recurring revenues
- In Q4, recurring revenue was 32% of total revenue, an increase of 1 point from a year ago
- Revenue from subscriptions was 56% of our total software revenue, up 5 points y-over-y

Deferred Revenues

- We drove good growth in deferred revenue, which was up 6% in total, with product up 15% and services up 1%

- Deferred product revenue from our recurring software and subscription offers was $6.1B, up 23%
- There was also a strong increase in the unbilled deferred, which is not on the balance sheet
  - The combined total deferred revenue plus unbilled deferred was up 28%

Acquisitions and Product Orders

- When we look at the impact of acquisitions on our Q4 results y-over-y, there was a 90-basis point positive impact on revenue
- We saw especially strong momentum in Q4, with total product orders growing 7%
- Looking at our geographies, Americas grew 6%, EMEA was up 6%, and APJC was up 12%
- Total emerging markets was up 12%, with the BRICs plus Mexico up 22%

Customer Segment

Enterprise, Commercial, Public Sector and Service Provider

- In our customer segment, Enterprise was up 11%, Commercial was up 9%, Public Sector was up 1%, and Service Provider returned to growth, up 6%
- Our product backlog at the end of Q4 was $6.6B, up 38% y-over-y

Gross Margins

- From a non-GAAP gross margin perspective, total Q4 gross margin was 62.9%, down 0.8 points
- Product gross margin was 61.5%, down 0.4 points, and service gross margin was 67.1%, down 1.7 points
- Product gross margin was down 0.4 points, driven by our APJC region related to some SP specific deals as well as negative product mix
  - Product gross margin for the Americas and EMEA were both up y-over-y

Pricing, Net Income, EPS and Tax Cuts

- Overall, pricing continued to have relatively modest erosion as you have seen over the past couple of quarters, and we continued to be negatively impacted by higher component costs which we expect to continue in the near term
- In terms of the bottom line from a GAAP perspective, Q4 net income was $3.8B and EPS was $0.81
- The GAAP results include an $863mm benefit related to the Tax Cuts and Jobs Act
  - We've excluded the benefit from our non-GAAP results

Cash and Investments

- We ended Q4 with total cash, cash equivalents, and investments of $46.5B.
- Q4 operating cash flow was $4.1B, up 2%, with FCF of $3.9B, also up 2%

- From a capital allocation perspective, we returned $7.5B to our shareholders during the quarter that was comprised of $6B of share repurchases and $1.5B for our quarterly dividend

Full FY

Revenues, Margins, Net Income, EPS and Cash Flows

- I'll now cover the full FY.
- We delivered solid revenue, margins, net income, EPS, and operating cash flows
- Revenue was $49.3B, up 3%
- Our non-GAAP operating margin rate was 31.1%
- Non-GAAP net income was $12.7B, up 5%, and non-GAAP EPS was $2.60, up 9%
- Our total non-GAAP gross margin was 63.8%, a decrease of 0.5 points, with product gross margin down 0.4 points and service gross margin down 0.9 points
- GAAP net income was $110mm, and GAAP EPS was $0.02, which includes the charges related to the Tax Cuts and Jobs Act of $10.4B.
- For the full FY, we delivered operating cash flow of $13.7B.
- We paid approximately $1.4B of one-time foreign taxes during the year related to the Tax Cuts and Jobs Act
- Operating cash flow increased 8% normalized for these tax payments

FCF, Share Repurchasing and Dividend

- We returned $23.6B to shareholders over the FY, which represented 184% of our FCF
- That was made up of $17.7B of share repurchases and $6B for our quarterly dividend

Summary

- To summarize, we had a strong Q4 and FY.
- We executed well with strong top line growth and profitability
- We're seeing the returns on the investments we're making in innovation and driving the shift to more software and subscriptions, delivering long-term growth and shareholder value
- As a reminder, we are adopting the new revenue recognition standard, ASC 606, as of Q1 FY2019 on the modified retrospective basis
- Its primary impact will be to accelerate our revenue recognition for certain software licenses and sales to two tier distributors, as well as a recognition of a deferred commissions asset that will be amortized over the terms of our sales contracts

Guidance

Revenue Growth, Gross Margin Rate and Tax Rate

- Let me reiterate our guidance for Q1 FY2019
- This guidance includes the type of forward-looking information that Marilyn referred to earlier
- We expect revenue growth in the range of 5% to 7% y-over-y
- This range includes the impact of ASC 606 which we estimate to be a benefit of about 1%
- 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 30% to 31% and the non-GAAP tax provision rate is expected to be 19%

EPS and SPVSS Transaction

- Non-GAAP EPS is expected to range from $0.70 to $0.72
- The guidance includes our Service Provider Video Software Solutions business that we recently agreed to sell and excludes the Duo acquisition since both transactions have not closed
- We expect the SPVSS transaction to close in H1 FY2019, subject to customary closing conditions and regulatory approvals

QUESTION AND ANSWER SECTION

<Q - Vijay Bhagavath>: My question to you, Chuck and Kelly, please chime in, is reasonable to assume you'd be extending the software subscriptions idea and plan across the portfolio? Give us an early glimpse as to how is it going or what were some of the challenges, what were some of the positive surprises. And would the makeup of the software subscriptions portfolio meaningfully change as you look to extend this model across the portfolio? Thanks.

<A - Charles H. Robbins>: Most of you know that when we began the sale of the Catalyst 9000, that was the first attempt to sell a subscription software offering on top of a core networking product and that has gone, as we've said on prior calls, reasonably well. I'm very pleased with how the adoption has been from our customers. They understand the value.

As I said early on, we put – we knew when we started that process that we would need to deliver significant innovation that wasn't available in the traditional methodology of buying it in order for our customers to adopt it and some of those were the Encrypted Traffic Analytics, the overarching analytic – I mean, the automation capability and then recently, some assurance. And you'll see us over the next coming quarters, when we bring new products to market in the – particularly in the enterprise networking space, but across the portfolio, we will apply that same strategy.

So I think that we've been pleased and our job now is to ensure that the operational infrastructure of the company is prepared and we're working towards being able to ensure that customers are deriving the value from that software, as well as obviously putting in the operational capabilities to ensure the renewals, et cetera. So that's what we're focused on. Kelly, any...

<Q - Rod Hall>: I'm kind of beside myself. Don't know where to start, these are so good, but let me – I guess let me kick-off with a question on the deferred revenue, Kelly. You said this off – including this off-balance sheet deferred, it's up 28%. Is that total deferred or product deferred? Can you just clarify what you meant by that? And also maybe help us understand what the ASC 606 impact on deferred was because that was, I guess, negative.

<A - Kelly A. Kramer>: On your question on the deferred revenue plus unbilled deferred, so that was up 28%. The big driver we have for that, that is just purely product, okay? So it is – what we mostly have in our unbilled deferred is from our Collaboration, our Applications business. They have a lot of periodic billing that they book month to month that is a very large number, so it is kind of apples to apples of business that we have booked that we will recognize in the future. So that's why we look at both.

When we do adopt ASC 606 for Q1, that will be one of our disclosures showing you the combination of deferred plus unbilled so you have our remaining performance obligations, but it is just product, that 28%.

As far as the ASC 606, we adopt that in Q1 so in the results, we just went through of the $6.1B of deferred from software and subscriptions, that is related to how we've been accounting for it under the old ASC 605. So when we go into Q1...

<Q - Rod Hall>: Can you just clarify, though, would you write-down – you'll write some of the deferred down in Q1 as a result of the change or not much or...

<A - Kelly A. Kramer>: I can give you some direction. You'll see that in our K, so we will be writing off a portion of that balance so of the $6B, we will be writing off and restating because you basically restate your balance sheet for the new accounting rules and like we've said over the past year, where we will have that impact is things that were term-based software licenses, things like our ELAs or Cisco ONE, those will now be recognized upfront where they used to be deferred. So the deferred revenue balance will be written down for that and will take -- so will take -- we'll lower the balance of the deferred revenue and then as we go into Q1, we'll be recognizing any new business that we bill upfront from that.

<Q - Ittai Kidron>: Maybe you can help me figure out how you manage to navigate so well in what seems to be such treacherous waters out there where between some deceleration in economic activity in Europe, the FX movement recently which is not favorable to you, although your price in dollars nonetheless makes your products a little bit more expensive internationally, poor CapEx matrix out of the large telcos, tariff wars globally. You seem to be moving along, sidestepping all of those things. Which of these things really bother you, concern you, you're watchful, you're preparing for?

And then second question, maybe you can kind of dig in a little bit on the networking, the Cat 9000, clearly good progress. Are there any customer matrix or anything you can give us there to help us solidify or get better visibility into the trend there?

<A - Charles H. Robbins>: I was feeling pretty good until you asked the first part of your question. No, I have said publicly, I think we're operating in a -- we have been operating in what I would call it's been a very consistent global economic scenario. There's clearly even in the last few weeks been things that have risen -- you've got the strengthening of the dollar that you mentioned, you've got some uncertainty in a couple of emerging countries, so those are clearly things that we'll watch and where we've seen these in the past and we know how to deal with them.

We obviously have the impending tariff situation which we're watching closely and on that front, we're in deep discussions in Washington with the administration on trying to get to a favorable outcome. We like to see that land in a good place, but overall, all of those are things that we are very actively involved with and we watch on a daily basis.

As it relates to the networking business, the Catalyst 9000, as I said previously, has been the fastest ramping product that we've ever built so the customer count became less of an indicator pretty quickly and it flowed through to the infrastructure systems growth that you saw this quarter, so we didn't see it as a metric that was – we usually use that metric on customer count when we're just trying to give you visibility to the ramp of a new product when it hasn't become real material to the revenue line. And I think that we exceeded that point in time with the Catalyst 9000 pretty quickly, but I will tell you just so you know, I think, Kelly, keep me honest on this, I think we had roughly 9,650-plus customers on the Catalyst 9000 as of the end of the quarter. We had a great Q4, great adoption, and we're very happy with where that product and that architecture is.

<Q - Pierre C. Ferragu>: I actually wanted to ask you about Service Provider. So you returned to growth this quarter, which is fantastic, and I think you mentioned as well that your routing business was weak and most of that weakness was in the Service Provider vertical as well. So I was curious to understand how you grew revenues there even if routing was negative or maybe I got something wrong. And then, of course, I'm very curious to hear whether this recovery in Service Provider spending might be driven by 5G already.

<A - Charles H. Robbins>: Let me answer the macro question about the overall situation we see in Service Provider, and then, Kelly, maybe you can cover the routing and the impact of the first part of the question.

So, Pierre, in the Service Provider space, we were obviously pleased. I've said a number of times over the last couple of years that this is a business that is dominated by large customers, and so as we've always said, when we have several of them that are slowing their spending, then it looks bad, when we have several that are spending, it looks pretty good, and that's just the nature of this business.

Relative to 5G, I will tell you that – I think I've said this on prior calls. Starting at Mobile World Congress earlier this year, we really – we heard these customers in earnest begin and engage in discussions around what network requirements would look like for the infrastructure to support 5G, assuming that they're going to add lots of hype, speed, connections at the edge, will require high performance networks with the quality of service and slicing and all those things.

So I would say that – I would not say that this is a material result of the implementation of 5G, to be honest. We expect that is still a year out before many will start and probably see it in earnest into 2020, to be fair. But we're pleased with what our teams have done. It's been a tough market. Our teams have continued to battle and our engineering team continues to work on next-generation innovation and we're pleased with the results this quarter. Kelly?

<A - Kelly A. Kramer>: And to the point of will I have better revenue, if you remember, last quarter, the SP segment was down 4% and you're seeing that flow through the revenue this quarter when we talked about routing overall. So, when I look forward, we don't kind of talk about our guidance in the upfront by business, but some of this on the order side might play well as we go into Q1.

What I will say, adding on to Chuck's comments is, I do think and, as you know very well, our Service Provider segment is made up of very, very large customers, and in any one quarter, we can get big orders and that can fluctuate around. So, as to the sustainability, I would say we feel good about our position, though I expect this could move around either way as we look forward.

<Q - Sami Badri>: My first question has a lot to do with Europe and the strength you saw in the region in this last quarter. And then is it safe to assume that going into next quarter and your very strong guidance, are you expecting to see the same kind of magnitude of strength in Europe again despite all the moving pieces politically?

And then the second question I really have is about the Viptela product launch. Are you addressing customers that are already big users, end customers of the campus product and the Meraki products to kind of upsell customers into your new Viptela product? Or maybe you can give us just an idea on the sales cycle and the customer base that you're addressing.

<A - Charles H. Robbins>: I'm going to answer the second one and then I'll give you a little qualitative color on Europe and then Kelly will answer the specifics on the business expectations.

So, on the second part of your question relative to Viptela and software-defined WAN, we have two offers. We have – Meraki has an offer for those customers who have embraced the Meraki architecture. They have a very effective SD-WAN solution that is actually being well-received in their customer base and they're using it to extend their customer base. So that's being very successful.

On the Viptela front, we have been working hard on the integration between the Viptela platform and Cisco's product, and so we're going to have a variety of offerings for our customers. We'll have a version that will have software running on different types of hardware. We'll have a software-only solution. We'll have our integrated ISR solution. And so we're seeing a number of those. This was a quarter where I would say we really saw the engagement level increase significantly. We got the offers in the marketplace, the first wave of those. And I said on Q3 call that our teams were signaling us that Q4 was where we're going to see some of this come to fruition and we in fact did.

So we feel good about where we are right now. There's more work to go. We haven't gotten the SD-WAN integration into DNA Center yet, so that will only be, I think, a positive boost when we get that done. The teams are working on that. I think it's coming in one of the upcoming releases. So, in general, we're pleased with where we are at this moment in time with Viptela.

Europe, our team's doing really well there. Our teams are executing well. I think that they are competing very well because we have some very tough competition there. The team in Europe is always one of the early teams leading with some of these new technology areas, so they've had a lot of success in this core enterprise networking space as we move to intent-based networking, so we're pleased with what they're doing. The entire global macro environment right now, there are so many dynamics that we're calling it like we see it based on what we know today.

And Kelly, you want to comment just on how we see the...?

<A - Kelly A. Kramer>: Just to add to your point, I think the environment is very strong in Europe despite the political things that are going on. And just as a data point, the UK is up double digits for us on product orders this quarter. So, again, I think like Chuck was saying, the overall environment is very favorable as of right now, so we're hoping we see this continued strength.

<A - Charles H. Robbins>: A lot of the innovation that we're bringing right now is actually targeted at helping our customers lower the expenses of running this infrastructure, so there is a significant play to be made in – almost like as customers look at where they are economically, there is reduction of costs by going to this automation platform, there is reduction of costs by moving to SD-WAN, so these are technologies that we are hopeful will continue to be important to our customers regardless.

<Q - Samik X. Chatterjee>: I just had a question on the guide for Q1. You clearly have good momentum on the top line, although when I look at the operating margin guidance, it's kind of flat y-over-y. So I just wanted to check, is there something that's limiting kind of the flow-through of the solid momentum on the top line to the operating margin? Is there something that's limiting the leverage of that to the bottom line? And is that something we should hope for in the future and provides kind of a second leg for the earnings growth?

<A - Kelly A. Kramer>: I don't think you need to read anything different of what's happening on the margin. I mean, if I look at the puts and takes that we have to our margin, I spoke a little bit about we can have – we have a little margin pressure this quarter and some specific deals in APJC but otherwise, our margin is driven by the same things, right?

Our pricing is very robust. We're being very disciplined. The price that you've seen the last couple quarters is in a range that's very, very strong so that's good. We are still facing component headwinds, and even though it's less of a headwind, it is still higher y-over-y. The prices are up as, again, just the slope is less, but that's part of what we see both in Q4 and the guide and then everything else kind of balances out. So right now, this is kind of what we see. We obviously are going to be driving for as much as we possibly can, but it's really the same dynamics.

<Q - Paul Silverstein>: A clarification question. Kelly, just in response -- your previous response, I trust you expect DRAM at a minimum to moderate come next year, and I'm wondering if you have any thoughts on the impact. And the larger question, I recognize this has been asked and answered in various forms, but Chuck and Kelly, my takeaway from your comments is that there's an awful lot of things going right and my simple question is, how much of this do you attribute to the macro? And I recognize even in that portion it's not simple in terms of different moving pieces globally, but how much of the strength is macro-related? How much of it is better execution in various areas like campus, switching, et cetera?

<A - Kelly A. Kramer>: On the component stuff, yeah, DRAM is loosening though, again, as I said, the prices still are up whether you look quarter-on-quarter or y-over-y. But we are optimistic that both on the demand side, which is also driving some of that pricing, we expect that to get better through 2019. And I don't know if you want to hit the other broader...

<A - Charles H. Robbins>: It's a virtually impossible question to answer, although I'm pragmatic enough to know that it's combination of both. I will say that I think that it's – clearly, the economy has been pretty consistent and the markets have been positive so that has certainly helped and I think correspondingly, this new architecture and the new technology that we brought out first -- about four quarters back actually right at the end of Q4 from a year earlier has clearly been adopted at a record pace for us, so I could never possibly give you any sort of split on what that looks like.

The best I can do is acknowledge that it's a bit of both and there are a lot of things going right, right now but there's also, as we said earlier and Ittai asked a question, there's a lot of dynamics out there that we're watching very closely. So sorry I can't give you a better, more specific answer, but I think that's as honest as I can be.

<Q - James E. Fish>: It's been a while since we got a Security Metric update. Can you just kind of walk through some of the past metrics you've given or what you're willing to give today? I know in the past you've given deferred revenue growth as well as penetration of certain products like FireAMP.

And then secondly, HyperFlex version 3.0 was released, I believe, recently. Can we get an update as to kind of how we should think about the sizing of that business or any metrics around hyperconverged infrastructure and how it's competing against the new Gen-Xs of the world? Thank you.

<A - Kelly A. Kramer>: Like I said in the prepared remarks, on the Security side, they continue to have -- they're over 60% of their business is software and so obviously, they have a lot of their business going through deferred revenue and it continues to grow in high double-digits so we feel good about that. They had a very strong Q4 and like I said, from a revenue perspective, it was broad-based this quarter, driving that 12% up on revenue. It was across all of their sub-segments. So I'd say it's continuing to grow very quickly and with this addition of Duo, it really just rounds out the portfolio very well.

In terms of HyperFlex, I mean, that's growing very strongly for us. I think this new release has been well received. And again, we find ourselves in a lot of head-to-head deals and winning against new Gen-X, which is obviously a really tough competitor out there, but we feel good about the offer we have. Now, it's really fairly small compared to the broader data center business that has all of our servers in there, but we're pleased with how it's ramping and how we're competing.

<Q - Simon M. Leopold>: I wanted to see if maybe we could talk a little bit long-term trending big picture around the concept of multi-cloud, which you talked about at Cisco Live and on a number of other occasions. Within the answer, I think, what I'm looking for is how does this help the evolution transformation and importantly, how does this help Cisco do more business with the web scale customers? Thank you.

<A - Charles H. Robbins>: The key message for us that we're trying to get across is that this transition to this multi-cloud world actually is changing the way our customers look at building their IT infrastructure and how they secure it. So if you just think very simply that -- look back over the last five to seven to 10 years, a great majority of the traffic in our enterprise customers' networks was terminating in their private data centers, so networks were architected and security architectures were built to deal with that reality.

Now, we're moving into a world where there is still some percentage depending on the customer of their traffic that is obviously terminating in the private data center. Then they have traffic terminating in SaaS applications in multiple public cloud providers. They have this whole IoT edge data aggregation issue so what's happened is the traffic flows in the way data is moving across their networks and across their infrastructure is much more complex than it was five to seven years ago where it was all very predictable, which leads us to – when you think about – ultimately, our customers are going to just need to build a world where you look at the user, you look at the application, you look at their policy and you look at the destination, and then you have technology in the network that actually provides policy, routing, quality security in that world. And that's the role that we're playing with our customers because they need to rearchitect their networks to accommodate a massively diverse traffic flow scenario that they're going to deal with. So I'll stop with that right now, but that's why it's so important.

And you ask, what does that do to our partnerships with the web scale providers? Well, they understand this dynamic that is going on, and so many of the -- you're seeing some of the early work we're doing with some of the web scale providers to ensure that we have integrated hybrid cloud solutions so that we can provide security and policy, whether applications or in the private data center or in the public.

They're interested in our ability to process data at the edge. As customers are building out IoT applications, they're interested in us helping define security architectures that make it simple for our customers to take advantage of their services so it's emerging as a really attractive partnership because of the reality that everybody sees in the marketplace today, and hopefully, that was clear. If not, we can have some folks talk to you afterwards.

<Q - Simon M. Leopold>: It's obviously a complex topic. Just trying to figure out how to bake it into a model.

<A - Charles H. Robbins>: I'll let Kelly talk to you about that one.

<Q - Jim Suva>: A quick question, Chuck. Earlier in your remarks, you mentioned with Service Provider strength coming back that you don't believe it's 5G-related. That's more of a 2020 phenomenon. Can you give us a little bit about a history lesson here of back in 3G or 4G or 2G uptakes, was there a linear into the build that happens? Is there a pause before the [ph] positive end (41:14) happens or is it just more of a steady as you go as we kind of look ahead more longer term and strategically to 5G and impact to Cisco?

<A - Charles H. Robbins>: And I think if you go back and look at the earlier transitions in this space, they have largely been around delivering – I don't want to say incrementally better, but a better performance for mobile devices that are connected to the network already. So when you go from 3G to 4G, you get better data performance, you're happier with your apps on your phones, et cetera.

This is a step level difference because we're talking about the latency dynamics of 5G and the belief that this will actually enable them to deliver real-time business applications to small offices or remote branches over 5G networks. That's a completely different dynamic. And so I would tell you that we don't know yet, but I think if you operate under the assumption that it lives up to its billing, then it is going to create a significant demand on the core networks of the service providers.

And so I can't say that there's a huge historical example for us to learn from. But I think what you're going to see is just between now and when they start building these things out, they're going to be working on design and then we're just going to see them begin to gradually build out. As they open up a certain market, they'll build out bandwidth and backbone capacity, and that's how we're thinking about it. And we'll be able to give you guys updates on upcoming quarters as to how we see this thing emerging. It's not going to happen overnight.

<Q - Tal Liani>: I want to ask about the routing. Just again, it's repeatedly under pressure and you gave an answer before about Viptela. You're saying that it's going according to the plan. I'm wondering if there's a link between the two yet or that the pressure in routing has to do with other things and not to do with SD-WAN. That's the first question kind of to understand or maybe you can provide different explanation to understand the pressure on routing and what's the outlook for recovery. Or is it like Nokia and others are saying that maybe there is a long-term pressure on this market.

Second question, just a follow-up on ASC 606; what's the impact on operating margin if you've provided this or you provide this information. Thanks.

<A - Charles H. Robbins>: Let me make a comment on the first one and then Kelly can add to it and she can give the ASC 606 answer as well. I think when you look at our routing business, first of all, Kelly, half of it, 50%, 60% of it is SP, right? I mean it's – so it's significantly impacted by the SP. Some of the players you mentioned, they probably have a much higher percentage of their routing businesses coming from service providers would be my guess. So that's just sort of couched in the discussion on 5G and everything that we've said so far, but SP, I'd say, is the answer on that piece of it.

From an enterprise perspective, Tal, I think over the last couple of years, we've just seen a classic architectural stall in the marketplace as we talked about historically when there's a big architectural transition. And you said that we believe Viptela was going according to plan. I think, well, the way I would characterize it is we've begun to see customers actually move forward with deployments, but it's early but we like where we are and we like what we see. So I think we'll see the enterprise continue to improve relative to this architectural clarity and I'll let Kelly answer sort of how you think about the overall routing or the ASC 606 question.

<A - Kelly A. Kramer>: On ASC 606, Tal, so just to kind of again ground everybody on how we're impacted on ASC 606. The one thing I will say is operationally nothing has changed. We've made no changes to our offers. We've made no changes to our contracts or any changes to our cash conversion cycle. So it is literally just an accounting change.

Now, what the implications are to us is like we said is it's going to accelerate some of our term-based licenses, so we will have to write-off some of our deferred revenue. We won't see that revenue, but we will offset that with acceleration of those offers when we book new orders and bill new orders. Net-net, we think it'll be a net positive for us of approximately 1%, and so that's the impact on the revenue. It will fall through down through margins, so it's on operating margin, 0.5 point to 70BPS roughly of goodness falling through there.

And as we go into the new rev standard as part of our disclosures, we'll be laying out very clearly for everybody, since we're adopting the modified retrospective approach, we'll layout very clearly the implications of the new accounting vs. what it would have been under the old accounting. So, hopefully, that answers your question.

<Q - George C. Notter>: I was curious about the revenue headwind that you're seeing from the subscription transition. You've talked about that in the past. I'm just curious about what that might have looked like in the July quarter and then what do you think that would look like for the October quarter?

<A - Kelly A. Kramer>: There's good news there, I would say. So like we anticipated, as we are so rapidly ramping the Cat 9000 and as we are blowing out DNA across not only that but also our Viptela offerings and across wireless, the revenue headwind was getting more closer to 2.5 points to 3 points.

Now, the good news on this is with the new revenue standard going forward, because it's accelerating some of these offers that we did have previously defer, that headwind will become less of a headwind, okay? So as opposed to the 2.5 points to 3 points under current accounting standards, that'll be much less closer to like 1.5 points or so if I had to guess roughly. And then again, this will all flush out as we go through it but it'll become less of a headwind because we have such a big portion of things that we will now be recognizing upfront.

<A - Charles H. Robbins>: You said that there's a 1% increase on the other side.

<A - Kelly A. Kramer>: On the revenue, exactly.

<A - Charles H. Robbins>: It kind of makes sense mathematically.

<A - Charles H. Robbins>: It would be coming down 1 point.

<A - Kelly A. Kramer>: The good thing about this accounting standard is it does normalize some of the natural headwinds we've had on revenue and margin because of it is now going to kind of come back and benefit us.

Marilyn Mora

Closing Remarks

Again, I'd like to remind the audience that in light of Regulation FD, Cisco's policy is not to comment on its financial guidance during the quarter unless it is done through an explicit public disclosure

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