Q4 2019 Earnings Call

Company Participants

- Chuck Robbins, Chairman and Chief Executive Officer
- Kelly A. Kramer, Executive Vice President and Chief Financial Officer
- Marilyn Mora, Head of Investor Relations

Other Participants

- James Faucette, Analyst
- Jeff Kvaal, Analyst
- Jim Suva, Analyst
- Paul Silverstein, Analyst
- Rod Hall, Analyst
- Sami Badri, Analyst
- Samik Chatterjee, Analyst
- Simon Leopold, Analyst
- Tal Liani, Analyst
- Tejas Venkatesh, Analyst
- Tim Long, Analyst

Presentation

Operator

Welcome to Cisco's Fourth Quarter Fiscal and Year 2019 Financial Results Conference Call. At the request of Cisco, today's conference is being recorded. If you have any objections, you may disconnect.

Now, I would like to introduce, Marilyn Mora, Head of Investor Relations. Ma'am, you may begin.

Marilyn Mora {BIO 19771101 <GO>}

Thanks, Michelle. Welcome, everyone, to Cisco's fourth quarter fiscal 2019 quarterly earnings conference call. This is Marilyn Mora, Head of Investor Relations, and I'm joined by Chuck Robbins, our Chairman and CEO; and Kelly Kramer, our CFO.

By now, you should have seen our earnings press release. A corresponding webcast with slides, including supplemental information, will be made available on our website in the Investor Relations section following the call.

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 we will discuss product results in terms of revenue and geographic and customer results in terms of product orders, unless stated otherwise.

All comparisons made throughout this call will be made on a year-over-year basis.

The matters we will be discussing today include forward-looking statements, including the guidance we will be providing for the first quarter of fiscal 2020. They are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically the most recent reports on Forms 10-K and 10-Q, which identify important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements.

With respect to guidance, please also see the slides and press release that accompanying this call for further details. Cisco will not comment on its financial guidance during the quarter, unless it is done through an explicit public disclosure.

In Q2, on October 28th, we completed the sale of our SPVSS business and accordingly had no revenue or expense from that business in Q4 fiscal 2019. As such, all of the revenue, non-GAAP and product orders information we will be discussing today is normalized to exclude the SPVSS business from our historical results. We have provided historical financial information for the SPVSS business in the slides that accompany this call and on our website to help understand these impacts. This guidance, we provided during our Q3 earnings call and today's call has been normalized in the same way.

With that, I'll now turn it over to Chuck.

Chuck Robbins {BIO 17845882 <GO>}

Thank you, Marilyn; and good afternoon, everyone. Our Q4 results marked a strong end to a great year. Our teams executed well through a very dynamic environment. We delivered significant innovation across our entire portfolio, and we continued our business model transition with software subscriptions now at 70% of total software revenue, up 12 points year-over-year. We delivered strong revenue and double-digit non-GAAP earnings per share growth for the full year and in the fourth quarter. We also continue to generate healthy margins, cash flow and returns for our shareholders. Our technology is fundamentally redefining IT architectures to help our customers manage the complexities of a multi-cloud world and transform for the future. Let me cover some recent highlights across our portfolio.

Starting with infrastructure platforms. We continue to see strong performance with broad-based growth across the majority of our portfolio led by our next generation enterprise networking solutions. Over the last two years, we have built the foundation for intent-based networking by re-architecting our entire networking portfolio to deliver new capabilities through our automation platform.

At Cisco Live, we launched several new technology innovations across networking domains to more effectively secure and manage users and applications across the entire enterprise from campus networks and wide area networks to data centers in the IoT Edge.

We also added several AI and ML software capabilities to improve network management through automation. A great example of this is our new AI network analytics capability, which delivers greater visibility and insights across the entire enterprise network.

In data center, we continue to execute well as we help enable our customers to securely access their applications and their data anywhere from private to public cloud environments, as well as at the Edge.

We are innovating across every facet of our portfolio integrating AI, automation, security and assurance into our Nexus switching platforms and our 400 gig offerings.

This quarter, we delivered data center network insights providing critical analytics and proactive network management capabilities through automation to increase our customers' ability to troubleshoot and remediate their environments. We also continue to invest in silicon and optics, to build the next generation Internet for our customers.

The recently announced intent to acquire Acacia is a good example of how we are enhancing our silicon and optics portfolio to enable web scale service provider and data center operator customers to meet today's fast growing consumer demand for data.

Now turning to security, which had an incredible year. Cyber security continues to be the top priority for our customers, driving another consecutive quarter of double-digit growth. As the industry leader in networking and cyber security, we are investing in and extending our subscription-based security innovations across all networking domains in today's zero trust environment.

By extending our ability to detect threats across public clouds and by protecting the campus, branch, WAN and data center against threats, we are the only Company providing an integrated end-to-end security architecture across multi cloud environments. Throughout the year, we've expanded our family of cloud security solutions to help secure identity, endpoints and the network, which has led to accelerating customer adoption as they move or expand to the cloud. We are also extending this protection from the network to branch offices to roaming users with flexible solutions designed to secure our customers' SD-WAN environments.

During the quarter, we were excited to announce the availability of a full Web proxy capability on our global SaaS platform umbrella to complement our on-premise appliances. Trust plays a critical role as customers access their network and applications and identity plays a critical role and delivering a secure, consistent experience, no matter how, when or where they connect. Those market dynamic was central to our Duo Security acquisition and we continue to see customer momentum reflecting the power of Duo's differentiated market leading SaaS platform.

Moving to applications. Our collaboration business continues to perform well, as we execute against our strategy to accelerate the future of work, communications and collaboration. Earlier this year, we shared our vision for cognitive collaboration, which we believe is quickly becoming the foundation to deliver massively personalized experiences and transform how we work. We are leading the market in integrating AI and ML into our enterprise collaboration portfolio, bringing intelligence and context to help our customers work smarter and increase productivity. Through our AI-driven innovations like people insights, facial recognition and Webex Assistant, we're driving expanded collaboration experiences on any device integrated with our customer's business process workflows.

Building on these cognitive innovations, we announced our intent to acquire Voicea, a market-leading provider of voice-based artificial intelligence solutions. With Voicea's technology, we will enhance our entire WebEx portfolio with a powerful transcription service combining AI and automated speech recognition to enable more actionable meetings, improved productivity, and enhanced experiences. We also achieved another outstanding quarter of growth with our AppDynamics, demonstrating rapid customer adoption of our differentiated end-to-end visibility and analytics platform from the end user, to the network, to the application.

In summary, we had a great quarter and finish to fiscal year 2019. And I'm proud of what our teams have accomplished. We are executing well in a time of uncertainty, delivering differentiated innovation across our portfolio and extending our market leadership and enterprise networking applications and security.

Our performance reflects our relevance, as well as the ongoing value we're providing our customers as they transform for the future. We are as committed as ever to providing them with the right innovation to drive greater impact and success. As I look ahead. I could not be more confident about our unique position in the market and the tremendous opportunity in front of us.

Kelly. I'll now turn it over to you.

Kelly A. Kramer {BIO 18951157 <GO>}

Thanks, Chuck. I'll start with a summary of our financial results for the quarter then cover the full fiscal year, followed by the guidance for Q1. Q4 was a great quarter across the business . We executed well with strong revenue growth, margins, net income and EPS. Total revenue was $13.4 billion, up 6%.

Our non-GAAP operating margin rate was 32.6%, up 1.4 points. Non-GAAP net income was $3.6 billion, up 9% and non-GAAP EPS was $0.83, up 19%. Let me provide some more detail on our Q4 revenue. Total product revenue was up 7% to $10.1 billion. Infrastructure platforms grew 6%. All of the businesses were up, with the exception of routing. Switching had a great quarter with double-digit growth, driven by both campus and data center with the continued ramp of the Cat 9K and strength of the Nexus 9K.

We saw solid growth in wireless across the portfolio. Data Center was up with growth in both HyperFlex and servers. Routing declined due to weakness in service provider. Applications was up 11% with collaboration, AppDynamics and IoT software all up double digits. Security was up 14% with strong performance in identity and access, advanced threat, unified threat and web security.

Service revenue was up 4% driven by software and solution support. We continue to transform our business, delivering more software offerings and driving more subscriptions. Software subscriptions were 70% of total software revenue up 12 points year-over-year. When we look at the impact of acquisitions on our Q4 results year-over-year. There was a 60 basis point positive impact on revenue.

In terms of orders in Q4. Total product orders growth was flat. Looking at our geographies, Americas was up 1%, EMEA was up 4% and APJC was down 8%. Total emerging markets was down 8% with the BRICS plus Mexico down 20%. In our Customer segments, enterprise was down 2%, commercial grew 7%, public sector was up 13% and service provider was down 21%. Remaining Performance Obligations or RPO at the end of Q4 was $25.3 billion. RPO is our deferred revenue plus unbilled deferred and represent total committed non-cancelable future revenue,

From a non-GAAP profitability perspective. Total Q4 gross margin was 65.5%, up 2.3 points. Product gross margin was 64.7% up 2.8 points and service gross margin was 67.9%, up 0.7 point. In terms of the bottom line from a GAAP perspective, Q4 net income was $2.2 billion and EPS was $0.51.

The GAAP results include a charge of approximately $900 million, which is a reversal of a tax benefit recorded in Q4 fiscal year ' 18 which relates to new US Treasury regulations issued during the quarter related to the Tax Cuts and Jobs Act.

We ended Q4 with total cash, cash equivalent and investments of $33.4 billion, operating cash flow was $3.9 billion, down 4%. From a capital allocation perspective, we returned 6 billion to shareholders during the quarter that was comprised of 4.5 billion of share repurchases and 1.5 billion for our quarterly dividend.

In our Q2 fiscal '18 earnings call, we said we would return $31 billion through share repurchases over the following 18 to 24 months. As of Q4 fiscal '19. We completed that commitment with share repurchases of 32.6 billion. Going forward, we will return to our capital allocation strategy of returning a minimum of 50% of our free cash flow to shareholders annually through share repurchases and dividend.

We continue to invest organically and inorganically in our innovation pipeline. During Q4, we announced our intent to acquire Acacia, an existing supplier that is focused on optical interconnect technologies. This move is consistent with our strategy of increasing investment in innovation and R&D for our growth areas. I'll now cover the full fiscal year results. We delivered strong revenue growth, margins, net income, EPS and operating cash flow. Revenue was $51.7 billion, up 7%. Total non-GAAP gross margin was 64.6% up 0.3 points and our non-GAAP operating margin rate was 32.3%, up 0.7 points.

From a bottom line perspective, non-GAAP net income was $13.8 billion, up 9% and non-GAAP EPS was $3.10 up 20%. GAAP net income was $11.6 billion and GAAP EPS was $2.61. We delivered operating cash flow of $15.8 billion, up 16%. Normalized for the tax payments related to the Tax Cuts and Jobs Act and each fiscal year and the cash received in Q1 fiscal ' 19 related to the legal settlement with Arista, operating cash flow was up 8%.

To summarize, we had a strong Q4 and fiscal year. We executed well the strong top line growth and profitability and we're seeing the returns and the investments we're making in innovation and driving the shift to more software and subscriptions delivering long-term growth and shareholder value. Let me reiterate, our guidance for the first quarter of fiscal '20.

This guidance includes the type of forward-looking information that Marilyn referred to earlier. Note that we have normalized our first quarter guidance to exclude the SPVSS business for Q1 fiscal ' 19 which we divested in October 28, 2018 . We have provided historical financial information for the SPVSS business in the slides that accompany this call.

We expect revenue growth in the range of 0% to 2% year-over-year. We anticipate the non-GAAP gross margin rate to be in the range of 64% to 65%. The non-GAAP operating margin rate is expected to be in the range of 32% to 33% and non-GAAP tax provision rate is expected to be 20%. The 1% increase in tax rate over fiscal '19 is primarily due to a forecasted decrease in tax benefit from foreign income.

Non-GAAP earnings per share is expected to range from $0.80 to $0.82.

I'll turn it back to Marilyn. So we can move into the Q&A.

Marilyn Mora {BIO 19771101 <GO>}

Thanks, Kelly. Michelle, let's go ahead and tee up and open the line for questions. And while Michelle is doing that. I'd like to remind the audience to limit yourself to one question.

Questions And Answers

A - Marilyn Mora {BIO 19771101 <GO>}

Thank you. Rod Hall from Goldman Sachs. You may go ahead.

Q - Rod Hall {BIO 20453923 <GO>}

Yeah. Hi, guys. Thanks for the question. I guess, I'm going to ask the obvious one, and then maybe, pepper in a little bit of detailed color if I can get it. The guidance is weaker than I think we had anticipated. We know it's a tough macro environment . So just hoping, Chuck, that you would maybe comment on that and maybe juxtapose the change in trend in enterprise orders which did weaken quite a bit with commercial, which seems to be holding up fine and kind of why that is going on. And then Kelly, if you could comment on backlog as well. I know, you guys, usually give it in the K, so it would be great to get that number as well. Thanks .

A - Chuck Robbins {BIO 17845882 <GO>}

Hey, Rod. Thanks for the question. So let me start by saying, first of all, the strategy and the work that we've done on our portfolio and the engagement with our customers is absolutely going in the right direction, and we continue to make progress and the strategy is working. So we're quite happy with what our teams have accomplished and where we are right now in that space. There is a couple of things that we saw in the quarter and I'll outline these. Then I'll answer, Rod. Your question about the enterprise. First, is it, we had continued challenges in service provider and I'll double click on that in just a moment.

As you saw in the order growth that Kelly talked about and then we did see in July some slight early indications of some macro shifts that we didn't see in the prior quarter. So those are the two things that happened. Let me double click on service provider just a bit. The Americas was generally the same from an order perspective from the prior quarter. So no real shift positive or negative.

Europe was actually positive in the SP space. In Asia, we saw continued weakening in our China service provider business and we had two massive build outs in India a year ago that just didn't replicate this year with the two major players there. That's the net of the service provider situation, it's not more complicated than that. If you look at our overall business, our orders outside of service provider grew mid-single digits. So we feel good in this environment about the rest of the portfolio and the work that we're doing those customers. As it relates to commercial enterprise and public sector and I'm going to probably give you little more granularity than normal just so you understand what we believe went on. You can see that the portfolio that is being sold into all three of those segments is obviously being well received, our public sector business on a global basis was up 13%. So we continue to see success.

And as you mentioned, Rod, global commercial was up 7. The enterprise business was really -- we saw weakness in China, which was contributed to it, we saw some weakness in the UK in enterprise and then candidly in the US as much as I don't want to -- use compares for any SKUs, we had two major software deals a year ago that were tough to compare against. So that's really it. The rest of the business and everything that we see is still very positive and we feel good about where we are.

Q - Rod Hall {BIO 20453923 <GO>}

Thanks for that, Chuck.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah, and Rod, on your backlog question. So we -- since we adopted ASC 606, we've been disclosing our RPO, which is a more meaningful metric of our future revenue because again with the -- the problem with our backlog, it didn't include our subscription businesses, so it didn't include anything on collaboration or security. So RPO has everything. It has the deferred revenue, the unbilled deferred and any committed future revenue and like we've disclosed in our queues, we expect of that $25.3 billion, we expect about 56% of that to be recognized over the next 12 months.

Q - Rod Hall {BIO 20453923 <GO>}

Okay, thanks a lot, Kelly.

A - Marilyn Mora {BIO 19771101 <GO>}

Next question please.

Operator

Paul Silverstein with Cowen. You may go ahead.

Q - Paul Silverstein {BIO 1812254 <GO>}

I appreciate it. Just to follow up on Rod's question, Chuck. A clarification. I felt China was not down or had been down for a while, so well less than 3% of revenue. And I guess, is not zero. So you still have exposure, but I'm surprised it impacted you to the extent you suggested. And then I want to ask Kelly about the pricing environment. I assume there's been no change and what we should expect for margins throughout the year, I assume they're going up on both the gross and the operating line given DRAM and given the ongoing shift to software, along with the benign pricing environment. But if you could comment on that?

A - Chuck Robbins {BIO 17845882 <GO>}

Yeah, let me just comment on the China situation , I mean you're right, it's down below 3%, it's a small part of our business, but obviously when it falls very dramatically, it can still have some impact because it is greater than zero, but long term, it's not a concern that I worry about much at this point. And so that's really the extent of what we saw there. I mean, the China reduction contributed to a point of the issue in all of enterprise for us. So it was that significant. And we definitely saw significant impact on our business in China as it relates to what's going on with the trade war right now.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yup. And then Paul on your margin question. So yeah, pricing, the environment stays good. Actually, we had a very good quarter on pricing. It was less than 1 point that you will see when we give you the Q. So that's been very good. And again, you can see, we are benefiting in our gross margins and OMs from the tailwind from DRAM as we expected and you're seeing that in not only the results, but also as we've been guiding on the margin.

Q - Paul Silverstein {BIO 1812254 <GO>}

Appreciate it.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Thanks, Paul

A - Marilyn Mora {BIO 19771101 <GO>}

Next question, please.

Operator

Thank you. Tejas Venkatesh from UBS. You may go ahead.

Q - Tejas Venkatesh {BIO 19639694 <GO>}

Thank you. You obviously give us year-over-year order growth number every quarter, but I wonder if you could give us a sense of what the sequentials look like versus historical seasonality. If I have my math right, sequential order growth looks somewhat in line with seasonality, but your revenue guide is a tad below where you've grown sequentially in recent years. So I just want to confirm, that's right. And then secondly, you are coming off a strong year of 7% revenue growth. I know you don't guide for the year, but investor expectations were somewhat high and I wonder if you could comment, even qualitatively on how to think about full-year revenue growth? Thank you very much.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Hey Tejas. So, yes, you're right on our sequentials on orders. I mean it's, we've had this phenomena. It's not a phenomenon, but our Q4, it always had a double-digit growth and Q4 is our largest quarter from a dollar perspective on orders growth for us. So that happens and again in Q1 it's a double-digit down. So this, the sequential isn't a change from historical and again, the year-over-year takes into account the kind of the phenomenon that we're seeing now.

In terms of the long-term guide. Again, we don't give more than one quarter, I would say to Chuck's earlier points, in terms of how we feel about the portfolio and the margins and the uptake, we feel good about that. The macro and the -- the certain segment issues like in SP, I mean, I think that's -- I don't foresee that. I'm not planning on that changing in the near term.

A - Marilyn Mora {BIO 19771101 <GO>}

Okay. Thanks, Kelly. Michelle, next question.

Operator

Sami Badri with Credit Suisse. You may go ahead

Q - Sami Badri {BIO 20178177 <GO>}

Hi, thank you. I was hoping you could kind of just give us an update on the campus switching refresh and then perhaps maybe your view on where will be next year, as you seek the campus switching cycle playing out and maybe even potentially more consistent data center switching deployments play out, especially since we're going through some transitions in the industry. So I guess, what I really wish want to understand is where we are in the cycle, were we in like the fifth maybe sixth maybe even first or second inning the way you see it and then maybe the equivalent of where we see that for data center switching for your customers?

A - Chuck Robbins {BIO 17845882 <GO>}

Yes, Sami thanks it's a great question. So in the last 120 days to 180 days. I mean, we completed the full refresh of our portfolio across switching, routing and wireless in the enterprise, and we are now in a position where all of those have mandatory subscription. So we've made that transition from a product development perspective, and now those all out in the marketplace with our customers.

On the Catalyst 9000, Q4 was the -- we added more customers in Q4 for the Catalyst 9000 than in any quarter prior. So that continues to move forward favorably. In the campus, what I would suggest to you is that we are, I'd say, maybe, we're in the second inning at this point of this transition that we see from our customers. As you know, they're all re-architecting their entire enterprise infrastructure to accommodate these traffic flows that are presented from the massive number of cloud applications that they're running. And so it requires a completely different architecture, which is what this portfolio is built for.

As it relates to data center, I think that next year, you'll probably begin to see some upgrades transitions when the pure 400 gig optics are available and one of the things that we believe is a big differentiator for us is that we're extending this policy management out of the data center into the campus from the campus into the wide area from the wide area into the cloud security portfolio. So we think being able to enable our customers to deliver policy from the data center, all the way across the campus to the branch into the cloud is a very unique differentiator for us and we think, we'll begin to see customers adopting and deploying that sometime in the next year as well. So that's how we see it playing out.

Q - Sami Badri {BIO 20178177 <GO>}

Got it. Thank you.

A - Marilyn Mora {BIO 19771101 <GO>}

Next question please.

Operator

Thank you, Tal Liani from Bank of America. You may go ahead.

Q - Tal Liani {BIO 1643846 <GO>}

Yes, hi guys. If you look at the growth this quarter, it's about 1% and then a few quarters ago.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Hey Tal, can you speak up just a little bit.

Q - Tal Liani {BIO 1643846 <GO>}

Yes. Can you hear me?

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah, better.

Q - Tal Liani {BIO 1643846 <GO>}

I'll pick it up here you go, now it's better. This quarter -- you're guiding for 1% growth, a few quarters ago, you reported 8% but you had roughly organically growing -- you were growing about 4% to 4.5%. Can you take the 1% that you have now and then build on top of it, all the things that you're seeing today to see what's the growth environment now that is more sustainable going forward? I'm trying -- I have difficulties to go from 4%, 4.5% to 1% within like three quarters. And if it's not a major deceleration in the growth environment. What could it be? So you mentioned China, what are the other things that are happening today that are unique to Q1 that are bringing the growth down so much from the levels we've seen just a few quarters ago?

A - Kelly A. Kramer {BIO 18951157 <GO>}

Hey Tal, I'll take a crack at it. I mean at the end of the day, when we are guiding, it's based on what we're seeing with the orders alone, the pipeline and everything else. And the biggest driver of the guide where it is the massive decline we've seen in service provider over the last two quarters. So that is the biggest driver. Again like Chuck said, we feel good about the rest of portfolio from an orders perspective growing in the mid-single digits but China is part of it but again, like we said it's small in comparison but SP is still a large part of the business and that's driving this outlook that you are seeing.

Q - Tal Liani {BIO 1643846 <GO>}

So what's the -- can you quantify this. Can you quantify what is the decline in the growth related to service providers and you think, you mentioned one point is related to China, am I correct?

A - Kelly A. Kramer {BIO 18951157 <GO>}

What we were talking about for that is for the orders rate that we just had the -- the orders rate for enterprise being down two points , one point and at the global level it was attributed just to China alone.

China overall was down over 25% this quarter for us.

Q - Tal Liani {BIO 1643846 <GO>}

Got it. And if I can just have a follow-up on China, we always thought that you're not selling much in China , that it's hard to compete in China. Where are you, where did you have position in China. I know you were selling some routers to service providers, but where are you selling in China and what's being impacted in China, what are the types of products that you're selling into the Chinese market.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah, I'm sorry.

A - Chuck Robbins {BIO 17845882 <GO>}

Yeah, let me just give you color and then Kelly, can give you some numbers , I mean Tal, the overall Chinese market, as I said earlier is certainly not a major play for us, but it has just dropped precipitously in light of the trade discussions. So it has, a short-term impact. And if you, where we were selling for years. We've sold infrastructure to the large carriers in China, which has just -- it's been slowly declining and we saw it even decline more rapidly last quarter. And then what we've seen is in the state-owned enterprises anymore.

We're just being -- we're being uninvited to bid. We're not being allowed to even participate anymore. So those are the enterprises. That's where the large impact was this past quarter. So it was, it was just a much faster decline of what we candidly expected.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah. And I would just to add to that. So again, we talked about the big impact it had on enterprise, had a, it was the second largest was down in service provider which is part of our overall service provider being down but from a product perspective. We sell everything there from switches, routers, all the way down through security and Meraki products, so we sell everything including cloud in China. And everything is being impacted.

Q - Tal Liani {BIO 1643846 <GO>}

Thank you.

A - Marilyn Mora {BIO 19771101 <GO>}

Thanks, Tal. Next question.

Operator

Thank you. Jim Suva from Citigroup Investment Research. You may go ahead.

Q - Jim Suva {BIO 6329522 <GO>}

Thank you very much, Chuck. And Kelly, you've been very clear about the softness in revenues. When -- or for the outlook. When you think about the outlook and a lot of it seems to be service provider softness that has not been a new theme, you've talked about it for the past several quarters.

So where we sit today looking out, is there a lot of risk that it could get worse. Or are you kind of looking at this, saying, we're kind of near a bottom for service provider trends because it's been chugging along pretty low and they're starting to sweat their assets, potentially, or is there still some risk that you have there. I was just kind of thinking about the service provider headwinds of could it get worse or is it you're looking at it and saying, hey, we're calling for a bottom.

A - Chuck Robbins {BIO 17845882 <GO>}

Look, I think that when you get into this area . There is certainly pressure in the business models across all different types of service providers. I think if you look at the early 5G buildouts, most of the telco customers we have particularly in Americas, they're focused on the consumer 5G trials today, they are not. I mean that is the primary focus and then getting there 5G consumer networks built out, but they also don't -- I would say, don't anticipate that being a huge profit driver off of the 5G transition that's going to come when they build more robust broader 5G infrastructure, where they will deliver enterprise services and that's going to come after they do the consumer side.

So it's a bit unclear when that will take place. I'd say, we are not modeling and don't anticipate any significant improvement in this business in the very near term. And we're just going have to wait and see. It's been a tough business for us for years and it's now, it obviously represents a much smaller percentage of our business than it did five years ago. But it clearly was a major point of weakness for us in the last quarter.

Q - Jim Suva {BIO 6329522 <GO>}

Thank you

A - Chuck Robbins {BIO 17845882 <GO>}

You want to add anything to that, Kelly.

A - Kelly A. Kramer {BIO 18951157 <GO>}

I think you got it.

A - Marilyn Mora {BIO 19771101 <GO>}

Thanks, Chuck. Let's go ahead and take the next question.

Operator

Thank you, James Faucette from Morgan Stanley. You may go ahead, sir.

Q - James Faucette {BIO 3580933 <GO>}

Great, thanks. I just had a couple of questions, one related to gross margins and one to the deferred revenue. On gross margins, Kelly. It looks like even though the August. I'm sorry, the July quarter was very good, is that you're guiding for on those to be -- gross margins to be flat to down a little bit and sequentially, historically, we've seen at least some improvement.

So I'm wondering, if you can help parse a little bit what may be going on there. And my second question is deferred revenue look -- actually looks quite good. So can you give us some insight into how much of that may be ELAs or software or other aspects. So we can get a little bit more color on what's driving the deferred revenue. Thanks.

A - Kelly A. Kramer {BIO 18951157 <GO>}

So on the margins. Yeah, I mean, I'd say the margins are going great. We feel good about it. I kept the range in that 64% to 65%, to take into account the cutting in of list four of the tariffs. Again we're going to run the same play that we have for all the other tariffs and we'll be, again, we continue to mitigate. We continue to do everything we can do, but we see that in that range, what I think is pretty good and as you look, as that falls down through OM, we're actually doing well and I've actually raised a little bit on the OM guide.

So again, I think we're able to offset the headwinds from tariffs with again continued benefit from the software, which leads to your point on the deferred revenue. Yeah, I mean, again, we continue to add to deferred revenue, which again is why I think looking at that RPO is a key metric which has both the deferred revenue as well as unbilled deferred, when you have month to months contracts. It shows the progress we've made.

Just to remind you guys, when we adopted ASC 606 at the beginning of the fiscal year, we wrote off $2.8 billion from our deferred revenue balance for the new accounting rules, and again, you're seeing just big sequential increases. Since then, as we just continue to ramp the portfolio with like for example, the entire enterprise portfolio that all have subscription, so it's broad-based.

We continue to have great adoption of the new products, all the subscriptions. We have great adoption of the ELAs. We had really strong performance of software and ELAs in Q4.

So it's all going in the right direction which is, again, that's why we're still -- despite any macro environment, why we're still bullish on the overall strategy of the Company, what we're doing on our transformation.

A - Chuck Robbins {BIO 17845882 <GO>}

Yeah James, if I might add to that. I know like three years ago. I think, I made a comment on one of the earnings calls that I felt like we had figured out how we could drive a subscription business on top of networking products. And now, here we are. And we've got every product in our portfolio on the enterprise networking now that has mandatory subscription and we really started selling that two years ago. So the first renewal window is really still a year away, so that's -- the team has done a great job that transition has been good.

We are on track with what we told everyone in the Financial Analyst Conference, where we'd be relative to our software and I think, that's what you're seeing show up in the RPO metrics as well.

A - Marilyn Mora {BIO 19771101 <GO>}

Thanks, Chuck. Next question.

Operator

Thank you, Tim Long from Barclays. You may go ahead.

Q - Tim Long {BIO 21123922 <GO>}

Sorry, thank you. Just a follow-up. And another question, if I could. Chuck, you mentioned, a little bit of the weakness was also related to some macro shifts in the month of July. Could you talk a little bit about that, kind of what we're seeing. Was it deals pushing out, scaling down, more competition, anything like that.

And then you also had mentioned the move to 400-gig upgrades next year. Could you talk a little bit about how you think Cisco will fare in these data center deals as we move to 400-gig and this strategy to take in-house and develop more optics internally . Do you think that helps as early as that 400-gig transition. Thank you.

A - Chuck Robbins {BIO 17845882 <GO>}

Yeah. Thanks, Tim. So basically, we just, we just felt a slight difference in July . I mean, relative to the close rates and just, it just wasn't a stronger finish as we would normally expect particularly in Q4, and I think that's what kind of set off the flags for Kelly and I. I met with 17 customers in the last five-six business days and nothing has changed about how they're thinking about the role of technology and what we do and how we're playing there. So we're monitoring this, we're watching it, we will see obviously I think what we've seen in the markets in the last few weeks.

And what we hear from some of the other players would indicate that others have seen similar things, some a lot worse. And I do feel very good about our position and where we are in the level of criticality that we are playing with our customers now versus five years, six years ago. And I think that. So, I feel good about that piece, but that's really, that's really what we felt, and we'll just have to see how it plays out and whether we get any resolution on some of these major geopolitical issues that are sort of lingering out there.

I've said for like 18 months that I've been amazed at the resilience of the economy. And hopefully, it can bounce back pretty quick. If we get to some -- get more clarity on some of these issues, which I think people are just, I think they're just hedging their bets relative to some resolution on some of the stuff. And then the second question was around,

around the 400 gig and our own supply [ph]. Yeah, I'll tell you, we have. I feel good about it. Number one, we are in the game. We have our technology roadmaps mapped out, our teams have made these acquisitions, which allows us to have good control of our components that go into these products. We've talked to lots of customers, including the web-scale providers who are very supportive of where we're headed and what we're doing. They are supportive of the strategy, they like the acquisitions. And so we feel good that we'll be, we'll be in a good place in a much better position to compete in this transition than we were last time around. So I feel good about where we are.

Q - Tim Long {BIO 21123922 <GO>}

Okay, thank you.

A - Marilyn Mora {BIO 19771101 <GO>}

Next question, please.

Operator

Simon Leopold from Raymond James. You may go ahead.

Q - Simon Leopold {BIO 4081594 <GO>}

Thank you for taking the question. I know you don't want to guide beyond the quarter, but maybe if you could help us sort of level set how to think about the year given that, I think you're facing a pretty tough comparison in October and so guiding 0% to 2% seems to set a new level. But if I just apply normal seasonality through the balance of the year. It would look like the year-over-year growth rate should come back somewhat in the January through July quarters. I just want to see it, how we should think about really the full fiscal year trending?

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah. Hi, Simon. I think the way you're looking at, I mean, again, we don't guide and again there is a lot of unknown out there, but I'll say, the way you're thinking about, probably the right way. I think the way you're thinking about the second half. Certainly, you get more normalized compares on there in the second half, but I think, the way you're looking at it is very rational.

Q - Simon Leopold {BIO 4081594 <GO>}

Thanks. And just a quick, do you have a metric for percent of revenue that's recurring. I think, you've given it in the past. And now with the fiscal year over, hope you maybe have that number?

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah, Simon, we stopped -- when we -- we started this fiscal year on that when we adopted 606 because a lot of our recurring subscriptions, like for example DNA with the Cat 9K because of the accounting it changes how we have to recognize it. So that's why, really the metric that we talk about now is how much of our software revenue is subscription based. So recurring isn't as meaningful.

Q - Simon Leopold {BIO 4081594 <GO>}

Okay. Thanks for taking the questions.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Sure.

A - Marilyn Mora {BIO 19771101 <GO>}

Thanks, Simon. Next question.

Operator

Thank you. Jeff Kvaal from Nomura Instinet. You may go ahead.

Q - Jeff Kvaal {BIO 3233206 <GO>}

Thank you very much. Kelly. You had mentioned a little earlier that you're taking the operating margin up a shade and I'm wondering, if you could comment about how you are making the magic happen there in light of a little bit of a lower revenue trajectory than we all might have hoped for a few months ago. And then just to clarify, your capital return plan, it sounds like it's going to be mostly about the dividend here rather than buybacks going, going forward? Thanks.

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yes, sure. So on. Yeah, on the profitability, on OM, I think it's not magic right. It is, we are -- we're working the gross margins hard with like we talked earlier. And then we're also working the OpEx side hard as always -- as well. Our engineering teams do a really good job of rebalancing their portfolios and making sure they're investing in the right stuff and we are constantly driving for efficiency. So it's good old fashion running the business and executing well despite the topline. So that's how that's happening.

And on the capital allocation. Yeah. So if you go back to when we dig a tax reform back in Q2 of '18 and we announced the big buyback. We had a $31 billion authorization then and we said, we'd use that $31 billion. We did effectively use that up through then up until now -- the 18 months, and so now, since we've really gotten our balance sheet where we want it in terms of, we reduced our debt.

We've brought our cash balance from $74 billion back then now to $33 billion. We've reduced our debt from 35 down to 25. We're going to get back to our normal strategy, which is being very opportunistic when our stock is down like on days like today and buying, but really balancing between both the dividend and the buyback to be at least 50% of our free cash flow.

Q - Jeff Kvaal {BIO 3233206 <GO>}

Okay, thank you.

A - Marilyn Mora {BIO 19771101 <GO>}

Thanks, Kelly, Chuck. Our last question.

Operator

Thank you. Samik Chatterjee from JPMorgan. You may go ahead.

Q - Samik Chatterjee {BIO 15496543 <GO>}

Hi, thanks for squeezing me in here. I just wanted to follow up on the guidance, you guys mentioned the service provider weakness is kind of what's driving the weakness on the guide, although there seems to be a broader concern here from investors related to a slowdown in enterprise spending. So I just wanted to get your thoughts particularly given the change in the business towards kind of higher software subscription mix, how should we think about levers you can pull to drive growth even if enterprise spending does kind of see a slowdown next year? And just a quick follow-up at Cisco Live. The team had talked about a major refresh of the collaboration portfolio. So I just wanted to see what the early response to that refresh has been? Thank you.

A - Chuck Robbins {BIO 17845882 <GO>}

Yeah, I think one thing that is I think important to look at is when we talk about enterprise spending and when many companies talk about enterprise spending that would be a -- in some cases a combination, at a minimum of our enterprise and commercial business and in some cases, people would just include public sector in there, and that's sort of a view. And that when you put it all together, was actually quite healthy. The orders were quite healthy. We just had a little bit in July of a feel that we just didn't close as strong as we would like. And so we felt like there was even more that we could have done. And it just didn't feel like a normal Q4 finish and it felt a little bit like some of the macro issues, maybe manifesting themselves. So that's really what we saw there and then Kelly, you want to talk about the software and...

A - Kelly A. Kramer {BIO 18951157 <GO>}

Yeah, I mean, again, just on the software, I think again because more and more, and again, even despite like I talked about the write-off of deferred revenue at the adoption of 606, even despite that the amount of revenue -- software revenue coming off the balance sheet continue just to grow as we put more on the balance sheet. So that helps buffer, when you do go through any tough macro issue. So I think, we'll continue to add to that, and it will continue to help soften whenever there is any kind of macro slowdowns but it's, it's helping maintain kind of the growth that we do see going as well as margins.

Q - Samik Chatterjee {BIO 15496543 <GO>}

So any feedback on the collaboration portfolio?

A - Chuck Robbins {BIO 17845882 <GO>}

I'm sorry. Yeah, I think that what Amy and the team have been doing is really, they've been refreshing new elements of the portfolio with N units endpoints, they've been -- they've consolidated the -- to a single-user interface, we've got new refreshed versions of WebEx out there , they're bringing the cognitive capabilities in. There is a lot of new technology that they've been bringing. So I think they are in the midst of delivering on that right now and the results in that business, would suggest that our customers are viewing it favorably because it continues to perform really well for a decent sized business.

Q - Samik Chatterjee {BIO 15496543 <GO>}

Okay, thank you.

A - Chuck Robbins {BIO 17845882 <GO>}

Thank you. So I want to. I just want to thank everybody for joining us today. I -- look, we're four years in and I'm really proud of what our teams have accomplished. I mean, we've come a long way in four years, and I don't actually judge where we are based on this quarter. I think or the quarterly guidance. I think that what we've built in the portfolio, and the innovation and the value that we bring to our customers is sustaining and we'll continue to do that with our customers going forward. We have a strong record of our execution. I have high conviction in the portfolio and I think, we're well positioned for long-term growth opportunity. So thanks all of you for spending time with us today and thanks for the question.

A - Marilyn Mora {BIO 19771101 <GO>}

All right, thanks, Chuck. So Cisco's next quarterly earnings conference call, which will reflect our fiscal 2020 first quarter results will be on Wednesday, November 13, 2019 at 1:30 p.m. Pacific Time, 4:30 p.m. Eastern Time. 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. We now plan to close the call. If you have any further questions, feel free to contact the Cisco Investor Relations Group and we thank you very much for joining today.

Operator

And thank you for participating on today's conference call. If you would like to listen to the call in its entirety, you may call (866) 463-4969, for participants dialing outside the US, please dial (203) 369-1404. This concludes today's call. You may disconnect at this time.
