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F5 Networks' (FFIV) CEO François Locoh-Donou on Q4 2019 Results - Earnings Call Transcript

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FQ4: 10-23-19 Earnings Summary

Press Release *10-K*

EPS of $2.59 beats by $0.04 | Revenue of $590.39M (4.92% Y/Y) beats by $7.98M

Earning Call Audio

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F5 Networks, Inc. (NASDAQ:FFIV) Q4 2019 Earnings Conference Call October 23, 2019 4:30 PM ET

Company Participants

Suzanne DuLong – Vice President of Investor Relations

François Locoh-Donou – President and Chief Executive Officer

Frank Pelzer – Executive Vice President and Chief Financial Officer

Chad Whalen – Executive Vice President, Worldwide Sales

Kara Sprague – Executive Vice President and General Manager, Application Services

Conference Call Participants

Sami Badri – Credit Suisse

James Fish – Piper Jaffray

Ashwin Kesireddy – Goldman Sachs

Tim Long – Barclays

Paul Silverstein – Cowen

Alex Kurtz – KeyBanc Capital

Victor Chiu – Raymond James

Operator

Good afternoon, and welcome to the F5 Networks Fourth Quarter Fiscal 2019 Financial Results Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Also today's conference is being recorded. If anyone has any objection, please disconnect at this time.

I'll now turn the call over to Ms. Suzanne DuLong. Suzanne, you may begin.

Suzanne DuLong

I am Suzanne DuLong, F5's Vice President of Investor Relations. François Locoh-Donou, F5's President and CEO; and Frank Pelzer, F5's Executive Vice President and CFO, will be making prepared remarks on today's call. Other members of the F5 executive team are also on hand to answer questions during the Q&A portion of the call.

A copy of today's press release is available on our website at f5.com, where an archived version of the call also will be available through January 27, 2020. The replay of today's discussion will be available through midnight Pacific Time tomorrow, October 24, by dialing 800-585-8367 or 416-621-4642. For additional information or follow-up questions, please reach out to me directly at s.dulong@F5.com.

Our discussion today will contain forward-looking statements, which includes words such as believe, anticipate, expect and target. These forward-looking statements involve uncertainties and risks that may cause our actual results to differ materially [indiscernible] implied by these statements. Factors that may affect our results are summarized in the press release announcing our financial results and described in detail in our SEC filings. Please note that F5 has no duty to update any information presented in this call.

With that, I will turn the call over to François.

François Locoh-Donou

Thank you, Suzanne, and good afternoon, everyone. Thank you for joining us today. I'll talk briefly to our business drivers before handing over to Frank to review the quarter's results in detail. Customer demand for consistent application security and reliable application performance across multi-cloud environments drove 5% total revenue growth in our fourth quarter. Strong customer demand for security use cases including web application firewall and identity of our proxy as well as continue the ELA traction fueled our second consecutive quarter of 91% software growth and drove overall product revenue growth of 3%.

F5's application services are making it possible for enterprises and service providers across the globe to deliver digital experiences with the reliability and speed their end customers expect. Our software growth was partially offset by our systems business, which was down 13% as customers increasingly look to consume F5 services and software. Our services business delivered a strong 6% revenue growth and continues to produce robust gross margin with consistently strong attach rates.

I will speak more to our business dynamics later in my remarks. Overall, we are pleased by the acceleration in our transition to more of a software driven business and the team is executing very well that gives our long-term strategy. Frank?

Frank Pelzer

Thank you, François, and good afternoon, everyone. As François noted, we delivered another quarter of strong revenue growth. I'll speak first to our fourth quarter and then to our fiscal year results. Q4 was our first full quarter with NGINX. NGINX's contribution is fully integrated into our results.

Fourth quarter revenue of $590.4 million was up approximately 5% year-over-year and above the top end of our guided range of $577 million to $587 million. GAAP net income for the quarter was $94.8 million or $1.57 per share. Non-GAAP net income was $156.7 million or $2.59 per share also above the top end of our guidance range.

Q4 product revenue of $265 million was up 3% year-over-year and accounted for approximately 45% of total revenue. As François mentioned, software grew 91% year-over-year for the second consecutive quarter. Software represented approximately 31% of product revenue in Q4, up from approximately 27% in Q3 and from 17% in the year ago quarter. We continue to experience strong uptake on our software solutions sold as ELAs and annual subscriptions. The contribution from ELAs was up quarter-over-quarter and up substantially year-over-year.

I will take a moment to elaborate on the impact of the implementation of 606, which was a source of some discussion with investors last quarter. Let me give you the punchline though, which is that the adoption of 606 hardly impacted our year-over-year software revenue growth in Q4. Let me explain why. Under the modified retrospective approach to ASC 606, we are required to compare our 606 Q4 2019 results to what they would have been under 605. In Q4, we estimate the implementation of 606 had a similar impact to Q3. The 606 to 605 comparison is not meaningful for a measuring our software growth, because nearly all of our 2018 revenue came from perpetual licenses or other consumption models not impacted by 606.

In the year ago quarter had 606 been in effect, the net impact to the software revenue would have been de minimis slightly more than $100,000, which means our Q4 software growth rate using 606 and FY2019 compared to FY2018 would have been approximately 90%, said differently, our software revenue growth is being driven by new offerings and new consumption models and not an acceleration of an existing run rate of subscription revenue.

Moving on, systems revenue of $182 million made up approximately 69% of product revenue and was down 15% year-over-year, as customers continue to accelerate their transition to software based solutions. Services revenue of $325 million grew 6% year-over-year and represented approximately 55% of total revenue.

On a regional basis, in Q4, America's revenue delivered an exceptionally strong quarter with the 11% revenue growth year-over-year and represented 59% of total revenue. EMEA was down 3% and accounted for 23% of revenue, while APAC was down 2% and accounted for 18% of revenue.

Looking at our bookings by vertical, enterprise customers represented 61% of product bookings and service providers accounted for 17%. Our government business was very strong representing 22% of product bookings, including 13% from U.S. Federal. In Q4, we had three greater than 10% distributors: Ingram Micro, which accounted for 18% of total revenue and Carahsoft and Tech Data, each of which accounted for 10%.

Let's now discuss our FY Q4 2019 operating results. GAAP gross margin in Q4 was 84.6%. Non-GAAP gross margin was 86.3%. GAAP operating expenses were $385 million. Non-GAAP operating expenses were $317 million. Non-GAAP operating expenses were higher than our expectations as a result of the higher sales commissions related to software sales. Our GAAP operating margin in Q4 was 19.4% and our non-GAAP operating margin was 32.6%. Our GAAP effective tax rate for the quarter was 19.7%. Our non-GAAP effective tax rate was 20%.

Turning to the balance sheet. In Q4 we generated $206 million in cash flow from operations, up slightly from last year. Cash and investments totaled approximately $1.3 billion at quarter end. DSO was 49 days and capital expenditures for the quarter were $21 million, down sequentially as we completed the final phases of building out our new Downtown Seattle facility. Deferred revenue increased 18% year-over-year to $1.2 billion less than half the increase over the prior year quarter relates to the adoption of 606.

We ended the quarter with approximately 5,325 employees, up approximately 130 employees from Q3 reflecting our continued investment in growth areas including sales and research and development. In Q4 we did not repurchase any of our common stock. We continue to view cash as a strategic asset for our future growth. So our primary focus with cash generation is augmenting our strong balance sheet and building a war chest for strategic purposes, we may opt to repurchase shares during any open trading window.

Let's briefly discuss our fiscal year results. For the full year total revenue grew 4% to $2.24 billion. Product revenue of $986 million grew 3% from the prior year and accounted for 44% of total revenue. Within product revenue software grew 60%, while systems revenue declined 8%. Services revenue of $1.26 billion grew approximately 5% during the year and represented 56% of total revenue. GAAP net income for FY2019 was $427.7 million or $7.8 per share. Non-GAAP net income was $626.3 million or $10.36 per share. For FY2019 cash flow from operations totaled $748 million down $13 million from FY2018 largely as a result of the NGINX acquisition. Capital expenditures were $104 million.

Now let me share our guidance for fiscal Q1 of 2020. Unless otherwise stated, please note that my guidance comments reference non-GAAP operating metrics. We continue to make strong progress transitioning our business to a software-driven model. We confident in our position in the market and expect our growth will be driven by the growth of applications and increasing demand for our multi-cloud application services.

We also expect continued strong demand for our software solutions add subscription and ELA offerings. With this in mind, we are targeting Q1 2020 revenue in the range of $560 million to $570 million. We expect gross margins of approximately 86%. We estimate operating expenses of $296 million to $308 million. We anticipate our effective tax rate for Q1 will remain in the 21% to 22% range. Our Q1 earnings target is $2.41 to $2.44 per share. In the quarter, we expect share-based compensation expense of approximately $46 million and $4.6 million in amortization of purchased intangible assets.

Finally, as has been our practice, we want to provide you with a high level fiscal 2020 modeling assumptions. First, we are tracking to our Horizon 1 outlook for mid single digit total revenue growth and anticipate a continuation of the trend we saw in the second half of the FY2019 with customers accelerating the transition of their applications to software-based solutions. On FY2020 operating metrics, we anticipate gross margins of approximately 86% for the year.

Following our typical seasonal pattern, we would expect operating margins to move down in Q2 from Q1 and then increase in the second half with full year results within the Horizon 1 range of 33% to 35%. We expect FY2020 stock-based compensation in the range of $185 million to $195 million and capital expenditures in the range of $50 million to $70 million. We expect to update our Horizon 2 outlook at our next Analyst and Investor Day, which we have scheduled for March 3, 2020 in New York. Details will follow as we get closer to the date.

With that, I will turn the call back over to François. François?

François Locoh-Donou

Thank you, Frank. I will speak to some of the business trends we are seeing, highlight some customer wins in the quarter and speak to why we think we are well positioned to capitalize on sky rocketing application growth before moving to Q&A.

But first, I want to highlight the partner news we announced today with Amazon Web Services. We have signed a strategic collaboration agreement with AWS. The agreement outlines specific areas of collaboration across our field sales, solution architecture and professional services team. F5 will now have dedicated AWS solutions architect and professional services resources trained on F5's technical architecture and our application services across all product lines and geographic theaters. They will be designing F5 into their solutions for existing and new cloud native customers.

Additionally, we have agreed to jointly collaborate on new offerings integrating F5 application services with AWS services Control Tower, CloudFront and other core offerings. We expect this will result in improved customer experience for those customers extending their existing workloads to AWS and for new cloud native applications being deployed in public cloud. We are excited with this next step in our partnership with AWS. For our joint customers, our collaboration will reduce the complexities of securing their assets with a consistent security posture and policy management in hybrid cloud deployments.

Now let me turn to the fourth quarter and the tremendous progress we are making in transforming F5's business and driving software revenue growth. Last quarter, we said that from our customer's perspective, it is clear that F5 has moved beyond a traditional ADC player. This quarter's results provide another data point of our progress and highlight the fact that F5 is emerging as a leader in a rapidly expanding in multi-cloud application services space.

Our customers increasingly want to consume more of F5 services on software and to securely deploy application faster. We have taken a number of steps to unlock this market demand. First, we have created new consumption models, making F5 services available in subscription and ELAs. In doing so, we are reducing friction for both enterprise and service provider customers and sharing easier software provisioning and reducing operating complexity.

As Frank mentioned, we continue to see strong subscription and ELA traction in Q4. In some cases, we are seeing opportunities to expand our revenue opportunity with customers with whom we have already secured an ELA. For instance, last quarter, we mentioned we had closed an ELA with a large next-generation mobile carrier in APAC, where our 5G-ready NFV solutions would address their growing 4G mobile broadband consumer services. I am pleased to announce today that the customer is Rakuten, and during Q4, we secured a second all software use case with them for Gi firewall.

Second, we are enabling more automation and orchestration on our platforms to enable faster application provisioning. In a real world example of customer impact, we are providing one of the world's leading converged video broadband and communication companies. It cloud based disaster recovery solution for their mission critical entertainment back office support service. In the case of high failure, a disaster recovery solution is activated replicating the customer's back office support service in AWS.

F5 BIG-IQ, the central management solution for BIG-IP provides the functionality to automatically start F5's BIG-IP Virtual edition in AWS, when needed. It also provides application and performance visibility of the activated disaster recovery system. In addition, BIG-IQ is providing on-demand licenses for the BIG-IP Virtual editions, which are being consumed under an ELA to ensure cost effective consumption based licensing for the disaster recovery infrastructure.

Third, with NGINX, we are enabling application services consumption in native container environment. As an example, during Q4, we secured a joint F5 NGINX win with an EMEA based financial tech customer. This customer was an existing F5 customer and also a longtime user of NGINX open-source for application services in their microservices environments.

The customer development team had built functionality on top of NGINX as open-source edition to achieve the level of functionality their business demanded. As the scaled, however, this do it yourself approach became difficult to manage. The combine F5 and NGINX team works together to demonstrate that standardizing on NGINX Plus with software support would deliver better value for the customers development and operations teams.

Fourth, we are expanding all our security offerings to software form factors. We continue to see strength in our software security business, as customers tap into the efficiency and scale of the public cloud while utilizing F5 to secure their applications and maximize availability. During Q4, for instance, a large credit union with well over 1 million members chose F5 to protect their apps as they expand to the public cloud.

The customer wanted the efficiency of the cloud along with a consistent set of application protection policies that matched their on-premise security. They are fully integrating the F5 solution into a CI/CD pipeline, utilizing the F5 automation tool chain, BIG-IQ and advanced security features in our web application firewall.

First and finally, we also are providing solutions specific to the software consumption needs of our service provider customers. In a Q4 win, with an EMEA based service provider, for instance, we sold virtual Gi LAN capacity expansions with VNF Manager in a win that included systems, software, NFV and professional services.

As a result of these actions and our customers' ability to operationalize and manage virtual infrastructures, we are also experiencing changes in our systems business. What I would ask that you keep in mind as we work our way through this model transition is that F5 is different from traditional hardware data center vendors. Our value proposition is and always has been in our software and application fluency.

As a result, the value we bring to our customers is not tied to the data center, rather it moves with the application. So as we continue to take steps to untether our software from proper sale hardware, we are capturing growth in new forms of consumption of our applications services. While we believe software use case are, and we'll remain top of mind for customers, we do see systems demand in certain high-performance use cases. With customers' that wants to control and manage end-to-end application delivery in certain key customer segments and in some emerging geographies.

As an example, during Q4, we worked with a state-owned real estate company in APAC that was looking to refresh F5 solutions that were approaching the end of support. We initially viewed these simple systems refresh opportunity. However, we learned the customer was also looking to enhance and improve the current web solution.

They were also planning an upgrade to comply with the application infrastructure architecture standard, had issues with their single sign on solution and suffered from an inefficient security chain. We won the deal with a systems based solution that combined our local traffic manager with our Application Security Manager, SSL Orchestration and Access Policy Manager.

Before I move on from Q4, let me also provide a brief update on NGINX. In our first full quarter, as a united F5 NGINX team, we continue to drive our value creation plan at a rapid pace. Our first combined solution, the controller that builds on the already successful NGINX controller with enhanced enterprise class features is on plan for release the end of January 2020.

We expect this converge solution will be an accelerator for NGINX business, expanding both the addressable market and potential deal sizes by spending a broader set of use cases across DevOps and Super-NetOps customer personas.

F5 and NGINX sales teams are coming together well with tighter go-to-market teamwork and collaboration which we expect will only accelerate in 2020. I will spend just a few minutes speaking to how we see our opportunity unfolding in fiscal year 2020 and beyond, before we move to Q&A. We are focused on expanding our leadership in multi-cloud application services. On driving continued software growth on BIG-IP Virtual Edition as well as on NGINX and our Cloud Services SaaS platform. At the same time, we are working to forge new world's go-to-market capabilities, to expand our reach to DevOps, to strengthen enterprise competences on supporting and growing a subscription business and to scale our public cloud partnerships. And we believe the size of our opportunity is growing.

On our March, 2018 Analyst and Investor Day, we said F5 growth opportunity was intrinsically linked to global application growth. IDC estimates that were more than 314 million enterprise application workloads globally in 2018, and forecast that number will grow to approximately 1.8 billion by 2023. At the same, time the number of applications is growing nearly 5x the complexity of deploying, managing and securing these applications is increasing.

Enterprises are embracing new, highly distributed architectures and multi-cloud environments. Simultaneously, the risk of cyber attacks and security threats is increasing with the majority of threats targeting applications or the identity of the person accessing that application. This set of challenges is F5's opportunity. In an increasingly fast-moving and complex environment, we are in a unique position to actually reduce the complexity of deploying applications across multi-cloud environments, to help our customers to develop, deploy, and scale their business driving applications significantly faster with substantial cost savings on the infrastructure required to support, manage and secure those applications. Perhaps most importantly, we are approaching this challenge with a customer focused mindset.

Let me elaborate. Over the course of 2019, I have had the opportunity to talk to customers around the globe that managed their application capital well, a strategic asset similar to how we manage physical and human capital. They all shared two common attributes. They consistently deliver a higher volume and faster velocity of code to user. What do I mean by that? Developers are core to building applications. They write the code that is the foundation of application, the business logic, backend component and customer facing interfaces.

However, building a great application is only half the journey. The other half is delivering that application, that code all the way to the mobile device, machine or browser that a NAND customer uses to access the application. The world's most competitive companies have mastered how to push code from development into production with velocity at high volume. They do it in minute. Good companies do it in days. For most, however, it still takes weeks and F5 can change that.

For example, we recently helped a large banking customer reduce the amount of time it takes to deliver code to users from 23 days down to just six minutes. With F5 solution, this customer is driving new revenue generating services and powering developers to be more productive and saving time and money on the infrastructure needed to support their application capital. Our customers can achieve results like this because we deliver the most comprehensive set of technologies and services available and we remove friction from the code to user delivery chain.

So how is this different from other approaches? Most vendors are trying to particularly integrate application services by tightly coupling the infrastructure and a siloed set of application services. We believe application services need to be infrastructure agnostic spanning from code to user. Ours is the only portfolio of application services that stretches horizontally from the servers that how develop a code all the way out to the devices that our customers use.

In other words, we are abstracting the application services from the infrastructure and making it possible for our customers applications to run anywhere, cloud, container, legacy with access to a consistent set of application services. We believe this horizontal approach better serve our customers and provide a sustainable differentiation in the market. During Q4, we shared this vision with more than 75 of our most important customers and 90 of our key partners at Aspire, our premier customer engagement forum hosted in Seattle.

The event brought 550 attendees to our new customer engagement center, including customers from every theater and every industry. The benefit of abstracting application services from network infrastructure resonated very well with attendees, who received custom demos and tailored sessions showing how F5 can help them move faster and more cost effectively. The reaction was very positive, and we’re looking forward to sharing this perspective with all of our customers in 2020.

In summary, we are entering 2020 in a position of strength. We built on our market leading ADC and security portfolio with BIG-IP, NGINX, F5 Cloud Services, Silverline and other investment, and continue to add new application services. We have added technologies that either provide or power app servers, Web servers, container networking, API solutions, DNS, distributed denial-of-service capabilities and content delivery networks. We are leveraging best-in-class application management and security services, a sticky base of thousands of enterprise customers, and real-time intelligence and action. And we will continue to enhance our ability to meet applications wherever they are, to simplify multi-cloud complexity for our customers and to expand the breadth of our application services, including expanding security services across all our platforms.

In closing, my thanks to the entire F5 team for driving a great quarter and year. Your grit, determination and flexibility is behind a significant transformation of our business that we believe will bring long-term returns to our customers and shareholders. My thanks also to our partners, our customers, and our shareholders for joining us on our journey.

With that, operator, we will now open the call to Q&A.

Question-and-Answer Session

Operator

[Operator Instructions] And our first question is from at Sami Badri with Credit Suisse. Your line is open.

Sami Badri

Hi, thank you. So you commented on the strength of software and the dynamics to expect in 2020. Just to give us a little bit more of an idea on how we should be modeling systems growth. Would you say that the dynamics and the growth rates that we've seen in the last two quarters in systems growth should all be – should also be extended through FY2020, with the software dynamics maintained?

François Locoh-Donou

Hi, Sami. Thanks for the question. So what you saw in the second half of 2020 is a acceleration in the decline of the systems business and also a very significant acceleration in our software business. I think that, that dynamic generally is going to continue in 2020, so relative to what we would have expected a year ago. We think we are ahead of plan on our transition, and that the – the software growth is going to be higher than what we thought and the systems decline is also going to be faster than what we would have thought in the past. That's driven by a combination of things. On the one hand, customers, we're seeing customers that have matured in their ability to consume application services and software.

So a number of customers have software first policies, have policies to leverage multi-cloud. They have more operational maturity around virtualization. And we seeing that both in enterprise and the service providers segment now. So there's a demand pull from the market. And there are also a number of things that we have done to accelerate that transition by enabling customers to consume our BIG-IP software in new consumption format, specifically subscriptions, enterprise license agreement, a lot of work with public cloud marketplaces.

We've done things like automation and orchestration that allow them to deploy applications faster in software. We've put a lot of our software in security and software consumption factors. And we've also done a lot of work to help service providers move to software. So when you combine a lot of the things that we have done as well as the demand from the market, you're going to see that trend continue. And for us, it's good because we feel that our strategic thesis is intact and we are ahead of our plan on our transition.

Sami Badri

Got it. Thank you for the color on that. And then the second question I had is, if you were to categorize the movements or I guess you could say the growth and strength in software and systems across your customer types across enterprise, SPs and government. Which one of these buckets is accelerating the systems decline versus which one of these buckets is actually accelerating the software adoption growth? Right. Just so we can get an idea on which customers are driving these changes?

François Locoh-Donou

I think all three have – Sami, I think all three have both trend to a degree. But I'll take them separately. So in the enterprise, I think that the transition towards software started in the enterprise earlier than the other two segments that you mentioned. And that trend is only accelerating for the reasons I mentioned around operational maturity, ability to operationalize, virtualization technologies and also the freedom of consumption that we have given them.

In the service providers segment, I would say it's only in the last couple of quarters that we – our customers have spoken about NFV for a number of years, but we are now seeing them really start to implement these virtualization technologies. In part, with in combination with 5G or in getting ready for 5G architectures, we're seeing more of our service provider customers adopt software architectures. I mentioned in the script, one of the customers we won Rakuten, which is who are building essentially a Telco, a next-gen Telco infrastructure that's 100% virtual. And so there, I think at one end of the spectrum what we're seeing a number of carriers move in that direction. And then I would say in the government, the transition is also happening but at a slower pace relative to the other two segments.

Sami Badri

Got it. Thank you. And then my last question for you is regarding the cash pile and war chest. So could you just give us an idea on specifically what you're looking for? You mentioned that the security offerings are not going to be following software form factors. Is that where you're going to spend the majority of your time to consider bolstering the business or using the war chest? Or could you just give us a better idea on what exactly you're looking for as opportunities?

François Locoh-Donou

No. Sami, I would – the way I'd characterize it for you is, we want to become the best application services platform in the industry. And I think the way to look at it is, if you look at everything that exists between an application and the user of that application, there is a set of services that are in that chain that includes things like load balancing and security and firewalls and app servers and web servers. We have significantly broadened our presence in the code to customer chain with the acquisition of NGINX. And our strategy is essentially to own that horizontal chain and provide the best application services that enhance this customer experience for users of an application.

And so when we look at – and that's kind of different than others who are perhaps pursuing more of a vertical approach where there are tied to a single siloed of infrastructure. We want to be 100% infrastructure agnostic, enable those application services for any app anywhere, regardless of how it's built and regardless of where it's deployed. And so in the context of that horizontal strategy we're looking at opportunities to broaden our portfolio organically or inorganically anywhere in that chain from code to customer. So security is of course an important component of that, but it's not the only one.

Sami Badri

Got it. Thank you.

Operator

Your next question is from a James Fish with Piper Jaffray. Your line is open.

James Fish

The guys, congrats on a great quarter here and thanks for the questions. Frank more for you. You called out large ELAs being up year-over-year. And sequentially, can you just give us a sense as to how much ELAs got booked as virtual versus appliances? Or any sense of how big the ELA businesses as a percentage now within F5 as it seems like it's becoming more material over the last few quarters.

Frank Pelzer

Sure. And James, thank you so much for the congratulations, we also thought it was a great quarter. We don't quantify the effects of ELA, and I did say that we were up in terms of dollars for four sequential quarters and the deal count was also up over a broader base, and we're seeing our ASPs up as well. And so we're really, really happy with the way ELAs are trending and that they are unlocking the spend that we see, we see very robust pipeline going forward, because we really only scratched the surface on the opportunity set within our customer base. Unfortunately, I'm not going to quantify the amount of ELAs, but I will say that it has been a positive trend for us.

James Fish

Got it. And then you guys had talked about the F5 and NGINX Controller kind of coming at year-end, it sounds like it actually got pushed a month. But also didn't really hear it too much around sort of the WAF-as-a-service global load balancer as a service. Any sense of the timing around those and how you guys are thinking about it for 2020? Thanks.

François Locoh-Donou

Hey James, I'll take that one. No, the controller – the combined controller with NGINX was not pushed out a month. I think we said January when we last spoke and we're well on track to be able to deliver on that. We're pretty excited about it, because it enhances the addressable market for NGINX in the number of personas inside of the enterprise, the large enterprises. As it relates to the other question I think related to F5 Cloud Services, which is our SaaS offering.

And we have released our DNS offering a few months ago. We just released earlier this month our global server load balancing as a service offering. And we're seeing strong interest in that. And then Web Application Firewall as a service, WAF-as-a-service is next on our roadmap and that should happen before the end of the calendar year.

James Fish

Got it, thanks. Congrats again guys.

Operator

Your next question is from Rod Hall with Goldman Sachs. Your line is open.

Ashwin Kesireddy

Hi, thank you for taking my question. This is Ashwin on behalf of Rod. I was just wondering if you could comment on the sustainability of the strength in the U.S. federal vertical and how you're thinking about that in fiscal 2020? And another question related to competitive dynamics, can you comment on any changes you are seeing in the company to landscape, any color on win rates or anything you can give us post the acquisition completion of VMware-Avi Networks acquisition will be great.

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François Locoh-Donou

Just – Ashwin, can you repeat the second part of the question? The first part was around the federal government. Then on the front of the second part…

Ashwin Kesireddy

The second was really on the competitive landscape following the acquisition of VMware-Avi Networks. Can you comment on any changes in win rates or anything there will be helpful?

François Locoh-Donou

Yes. Ashwin, I'll take the second part on the competitive landscape and then Chad will take the question on the federal government and the sustainability of our strength there. So essentially, we haven't seen a change in the competitive landscape after the acquisition of VMware-Avi – sorry, by VMware.

On the last call, I mentioned to you, we were not seeing Avi in very many deals and where we see them, we have been pretty happy and comfortable without win rates, and so essentially that hasn't changed. I would expect it to change with the presence and distribution that VMware has around the world. And to see them more overtime, especially in customers that have gone all in on NFX, and really are tied to that infrastructure. But we don't see that as a very large proportion of the market, so more to come on that, but so far no change.

Chad Whalen

Perfect. Good afternoon, Ashwin. This is Chad Whalen. Regarding the strength of the fed business in 2020, as we did in their release federal performance in Q4 was fantastic. Much of this is sustainable for a very simple reason. We're a built into very large programs across the federal government base from three ledger agencies all the way through the Department of Defense. And so for 2020, we're planning for a very robust year in the federal government space as well built upon much of what we've done over the last number of years within this – with this – excuse me, within this segment, drive in some of the key tenants within our security portfolio and some of the needs are unique to the federal government.

Ashwin Kesireddy

Thank you.

Operator

Your next question is from Tim Long with Barclays. Your line is open.

Tim Long

Thank you. Thanks a lot. Could you talk a little bit – two questions for me also. First, the new AWS partnership sounds like a nice expansion. Can you talk a little bit about the timing and when you think that could materially pick up kind of the cloud businesses for you and are there any other potential public cloud partnerships or expansions we should expect to see?

And then the second I wanted to follow back up on the systems business. Obviously, this transition going on just curious, is this scenario where we're going to need some kind of refresh for some of the customers? And if not given that it's becoming a smaller piece. From an investment standpoint, does this change the investment profile of the overall company where maybe there's a little less R&D or less of sales push on the hardware side and maybe that that means some overall better leverage on OpEx for the entire business. Thank you.

François Locoh-Donou

Thank you, Tim. So let me start with the – your questions around AWS and the public cloud. Just for context Tim, our software business as you see as accelerated very significantly in 2019. And if you look at the second half of the year where our software grew about 90% year-on-year, our public cloud business is actually grown faster than that all year. So it has continued to grow because of the integrations we already done with public cloud providers, the availability of our solutions in market places and also enabling our customers to for the licenses into public clouds.

And so as a result of all this, our public cloud business have become a meaningful portion of our overall software business. Now the partnership with AWS, takes that to a new level, because we have been meeting AWS in the market where customers want AWS and want F5 and ask us to get together and help them move forward with their public cloud initiatives. But now we're going to have a number of AWS solution architects and professional services people who are trained on F5 and are designing in F5 into their architectures and their solutions when they're engaging customers.

And AWS obviously has a lot more resources than we do. So we look at that as a multiplier effect of our own resources in the market to design often for customers that want to leverage public cloud infrastructure. So we're very excited about that. And we're also very excited about the collaboration we've agreed with them. On the product side, integrating things like our WAF into CloudFront to compliment their CDN with a security solution to enable them to better compete with the likes of Akamai and other integrations with a Control Tower, which is really how customers manage and deploy their applications in public cloud. So it's just going to give us an expanding surface into the public cloud and more visibility.

When that will impact our numbers? I think overall this is going to provide further acceleration to an already fast-growing public cloud business. And the specific impact of that partnership, I think is more of a second half of 2020 to 2021. But it could be significant.

On the second part of your question, which is on the hardware decline and what does that mean for our investments and potentially operating leverage. We're going to continue to manage the investment overall in hardware. We have a number of platforms that are in development that are going to come to market in the next few quarters. But overall, if you look at where we're at in terms of where we've guided to on operating profit for this year, we’ve said we would do about 33% to 35%, for the year and we expect to be in that range this year. And then, at our Analyst and Investor meeting, we will give you an update on what we think is going to happen in Horizon 2, which is 2021, 2022.

Tim Long

Okay. Thank you.

Operator

Your next question is from Paul Silverstein with Cowen. Your line is open.

Paul Silverstein

I’ve got some clarifications and then a couple of questions. First off, did you all give us the NGINX contribution? I know that the revenue was small at the time you acquired required them, but did you provide a number for NGINX?

Frank Pelzer

Paul, we did not. I mean, I told you in the call last quarter that we thought that it would be approximately $8 million. It was slightly more than that ever so slightly, but it was spun-on. And when you take a look at the inorganic and organic growth, it was almost the exact same as we had last quarter.

Paul Silverstein

And I trusted $8 million all software or primarily software?

Frank Pelzer

No, actually there’s a split between software and services. The software component was approximately $6 million and the services was just slightly over $2 million.

Paul Silverstein

I appreciate. That's helpful. Now let me ask my question relative to that. So your hardware was down 15%, following 11% decline. You obviously made that up with software and then some – and we all know that software pricing or at least I think software pricing, maybe I shouldn't be so cavalier about it, but that software pricing is well below hardware pricing I trust that's a given before I ask the real question.

Frank Pelzer

No, I don't think that's a given Paul.

Paul Silverstein

There goes my friend. I guess I want to try to decipher looking forward is normally when one sees hardware decline of this magnitude. I would expect that to swamp your ability to transition the model at least over a transitionary phase, but you just put a gruff. And I guess from a big picture perspective, I'm trying to decipher as we look forward what's going on and I've listened attentively to your call. You said a lot of things on a lot of trends like that's – this is the first quarter in the Americas, we've seen 11% year-over-year, 14% sequential. You haven't had a quarter of that type of growth in the Americas region in the U.S. You'd have to go back about three years at the same time you cited macro conditions for depressing for the decline in EMEA, which had been strong up until the beginning of this year and APAC, which has been more mixed.

So again, first of all, if I could ask you to take a step back and appreciate you've given us a lot of detailed information in the call, but from a big picture perspective, when you look at the regional trends, you look at the hardware to software mix before I ask you about margins, what's going on from a revenue perspective. The growth we saw in the Americas, is that the new norm?

François Locoh-Donou

Yes. Paul, I appreciate that there are lots of signals there that you're trying to make sense off. So let's talk about hardware, software first and then let's talk a little bit about geography. I mean, I think Paul, the reason I say it's not that the software price per unit is lower than the hardware price per unit is, because it really depends on the use case, the type of application, where it's deployed, what bundle of application services are used for that application. And in some cases, yes, it's lower, but there are a lot of cases where the software deal ends up being larger than the hardware deal would have been because the company can deploy more of it and more functions.

Paul Silverstein

I apologize for the interruption, but this exactly where I was going with this. I trust the reconciliations that unit volume, whether literally measured by units or measured by the use case that you're making up for the degradation on a like-for-like pricing basis, the differential between hardware and software and predating your arrival at F5, F5 consistently forever with site virtual additions at 80% of the price point of the hardware. I was assuming that hadn't changed or if anything is changed for the worst, not for the better. But assuming that's still the case, to the point you just made, I trust these deals are getting bigger and scope and that's why there's a possible offset in the revenue.

François Locoh-Donou

Yes. I think you're correct on both accounts. So it is still the case on your pricing comparison versus hardware, but in terms of the margin dollars to F5 that nets out to being about the same. If you just took pure functionality software versus software – software versus hardware, exactly the same functionality. What you said about the 70% to 80% versus 100% of hardware for the price per unit is true. But what happens when we are in – when we move to a software consumption form factor is that it's easier for us to expand our role with a customer, because they have more freedom to deploy the technology. They can add use cases faster. They can replicate the solution in multiple environments. And so the overall consumption becomes larger.

Now, if you look at the numbers I would point to, if you're looking our fiscal year 2018, our hardware only declined 4%, but our product revenue for the full year was flat with zero percent growth. If you look at 2019, our hardware declined 8%, but total product revenue was plus 3%. So you have kind of several quarters of us showing that the software growth is more than offsetting the hardware decline. And that's because our software story elevates our relevance with customers and gives us an opportunity to expand our role. I'll give you some examples in the script. The Rakuten deal I mentioned in Japan is a great example where we did a very large software deal with them and we came back three months later and already expended that with more kind of multimillion dollar software opportunity because of the speed of consumption and the number of use cases we're addressing. So that's our hardware software, Paul.

And if you tap out – touch a little bit on geography to your question. I think, we have seen EMEA, I think we continue to see micro uncertainty in Europe. And I don't see that changing in the first half of 2020 for a number of reasons that Brexit is a part of it. And generally, I think, Continental Europe, we're seeing just macro softness there. In North America, we had a very strong quarter in the federal government. We had a softer quarter in financial services and I would expect that we see better performance from financial services in the first half of 2020. And so generally, I expect North America to be healthy going into 2020.

Paul Silverstein

All right. Can I ask you quick question on margins? If your services have consistently been 87% plus minus 30 basis points over the past five quarters, your product margin was just subset over 85% following almost 84% last quarter from 82% to 83% in the nine previous quarters. I trust the improvements driven by the shift to software from hardware and I trust that trend should continue.

Frank Pelzer

That's right, Paul.

Paul Silverstein

All right, I'll pass it on. Thank you.

Operator

Your next question is from Alex Kurtz with KeyBanc Capital. Your line is open.

Alex Kurtz

Yes, thanks. Just a clarification then a question that the long term deferred, I think was strong in the quarter, just kind of what was the dynamic in short and long term. And then François, just kind of following up on Paul's question around, kind of share of wallet or how you're increasing use case within existing customers. So how does – what are the applications or the use cases that when you transition to software you make it more easily consumable that you're capturing, right, within existing account? Like what's that bell curve type of outcome that you're seeing right now?

Frank Pelzer

Sure. So – thanks, Alex. I think the on the long term deferred, a lot of that was driven by the growth of ELAs and some unbilled receivables. And so that's why you saw the strength in the long term deferred revenue.

François Locoh-Donou

And then, Alex, your second question is on the types of use cases that we're seeing.

Alex Kurtz

Yes. When you've transitioned most of your portfolio to software, you're talking about incremental use cases that allowing you to grow your share of wallet. So above and beyond the traditional ADC, like what are you seeing in these bigger software deals that are driving the bigger outcomes?

François Locoh-Donou

So now it's two things. Number one, you might see a deal in hardware that is load balancing only. And then – when we were in a software, because it's kind of natural for our customers to consolidate multiple software modules. We will do load balancing DNS WaaS and other capabilities. So you're adding more capabilities to the deal. But the other factor also is that when we're in software, a customer has an ability to deploy that, not just in their data center, but they'll deploy in a public cloud, they'll deploy it multiple public clouds, sometimes in private cloud. So you'll see more kind of replication of a virtual instance to F5.

And then the third factor that expands our opportunity in software is that the public cloud model for security is a shared security model, where the public cloud provider secures the neighborhood and the customer, the enterprise has to secure their home. And by definition, that's a forcing function for our customers to add more security to the software in the public cloud. And so as a result of that, our security attach rates in software use cases that are deployed in the cloud is much higher, if I could stumble the picture of the attach rates in on-prem. So those are the three factors that are driving expansion of the opportunity in software.

Alex Kurtz

Thank you.

Operator

Ladies and gentlemen, we do have time for one last question. The last question is from Simon Leopold with Raymond James. Your line is open.

Victor Chiu

Hi guys, this is Victor Chiu in for Simon Leopold. Can you tell us by your estimation, what portion of the ADC market has gone to the public cloud and what your view is on the trajectory in the rate of continued adoption? And I guess off of that – of your existing customers that have migrated at least some portion of their workloads, what portion continues to utilize F5 solutions there?

François Locoh-Donou

What was the second part of the question, Victor?

Victor Chiu

Of your existing customers that have migrated at least some portion of the workloads, what portion of them – do you expect continued or are continuing to utilize F5 solutions?

François Locoh-Donou

All right, I'll take the second part of your question, first. And then we'll come to the first part. Generally, Victor, customers who are on F5, on-prem who migrate to the public cloud majority of them are migrating with F5. And that's because it's a lot easier to do that than to go ahead and if you don't want to have to refactor an application, it's a lot easier to migrate with F5 than not. And that's one of the benefits for AWS also have the partnership with often allowed this migration to happen a lot faster, but the medivators – the vast majority of our customers who are on F5, to be on F5 in the public cloud.

Kara Sprague

Yes. And Victor, this is Kara. With regard to your first question, the question was about roughly what share of the ADC market, do we see having moved to the public cloud I think that's what you asked. What we actually see as these applications start getting lit up in public cloud is an expansion in terms of the use cases for ADC like technology. So what – it has typically been bucketed into the ADC market has been things that include load balancing, there's been parts of application security and other things. Those capabilities are getting lit up in public clouds, either through the public cloud native providers or through third party providers like F5. And in many cases, those applications that are there are oftentimes net new cloud native applications that are taking advantage of those services. And so that has been an expansion of the TAM for that market.

Victor Chiu

Right. And are there any headwinds competing with now in the public cloud alternative solutions guys like Amazon?

Kara Sprague

Well, you thought from the strategic agreement as we see, there's a lot more synergy between our two companies and a lot more of partnership opportunity than actual competition. And in fact, one of the big benefits that F5 brings to this – as F5 has been the go to ADC solution provider for our enterprise customers for their most important applications. Many of those most important applications are still sitting on-prem. And there looking at numerous public clouds vendors, for selection for their new workloads or for modernizing their old applications. In the case of the new workloads, they're finding use modernizing their old applications. In the case of the new workloads, they're finding use cases that apply for the public cloud native capabilities as well as use cases that apply for vendors like F5, especially, where they value that multi-cloud story. And for the modernization of their old applications, what we're finding is that our customers really want to move those applications and modernize them with F5, because it gives them an easier path into the public cloud.

Victor Chiu

Great. That's helpful. Thank you.

Operator

Ladies and gentlemen, a replay of today's call will be made available approximately two hours and will be accessible until November 6 at Midnight Eastern. To access the replay, you can dial 800-585-8367 in reference conference ID 8378996. Once again, please dial 800-585-8367 and reference conference ID 8378996. Thank you. This concludes today's conference call. Thank you for participation and you may now disconnect.