Seeking Alpha α
Transcripts | **Technology**

Arista Networks, Inc. (ANET) CEO Jayshree Ullal on Q3 2019 Results - Earnings Call Transcript

Nov. 1, 2019 1:25 AM ET5 comments | 5 Likes
by: SA Transcripts

Q3: 10-31-19 Earnings Summary

Press Release *Slides*

EPS of $2.69 beats by $0.28 | Revenue of $654.41M (16.17% Y/Y) beats by $1.15M

Earning Call Audio

Subscribers Only

0:00:00 -1:00:59

Arista Networks, Inc. (NYSE:ANET) Q3 2019 Results Conference Call October 31, 2019 4:30 PM ET

Company Participants

Charles Yager - Director, Product and Investor Advocacy

Jayshree Ullal - President and CEO

Ita Brennan - CFO

Anshul Sadana - COO

Conference Call Participants

Simon Leopold - Raymond James

Tim Long - Barclays

Ittai Kidron - Oppenheimer

Samik Chatterjee - JP Morgan

Alex Henderson - Needham and Company

James Faucette - Morgan Stanley

Aaron Rakers - Wells Fargo

Alex Kurtz - KeyBanc Capital Markets

Tejas Venkatesh - UBS

Jim Suva - Citi

Rod Hall - Goldman Sachs

Amit Daryanani - Evercore

Brian Young - Deutsche Bank

Paul Silverstein - Cowen & Company

Jeff Kvaal - Nomura Instinet

Sami Badri - Credit Suisse

Erik Suppiger - JMP Securities

Tal Liani - Bank of America Merrill Lynch

George Notter - Jefferies

Hendi Susanto - Gabelli

John Marchetti - Stifel

Andrew Vadheim - Wolfe Research

Operator

Welcome to the Third Quarter 2019 Arista Networks Financial Results Earnings Conference Call. During the call, all participants will be in a listen-only mode. After the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time. [Operator Instructions] As a reminder, this conference is being recorded and will be available for replay from the Investor Relations section at the Arista website following this call.

I will now turn the call over to Mr. Charles Yager, Director of Product and Investor Advocacy. Sir, you may begin.

Charles Yager

Thank you, operator. Good afternoon, everyone, and thank you for joining us.

With me on today's call are Jayshree Ullal, Arista Networks' President and Chief Executive Officer; and Ita Brennan, Arista's Chief Financial Officer.

This afternoon, Arista Networks issued a press release announcing the results for its fiscal third quarter ended September 30, 2019. If you would like a copy of the release, you can access it online at the Company's website.

During the course of this conference call, Arista Networks' management will make forward-looking statements including those relating to our financial outlook for the fourth quarter of the 2019 fiscal year, longer term financial outlooks, industry innovation, our market opportunity, the benefits of recent acquisitions, and the impact of litigations, which are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically in our most recent Form 10-Q and Form 10-K, and which could cause actual results to differ materially from those anticipated by these statements.

These forward-looking statements apply as of today, and you should not rely on them as representing our views in the future. We undertake no obligation to update these statements after this call. Also, please note certain financial measures we use on this call are expressed on a non-GAAP basis and have been adjusted to exclude certain charges. We have provided reconciliations of these non-GAAP financial measures to GAAP financial measures in our earnings press release.

With that, I'll turn the call over to Jayshree.

Jayshree Ullal

Thank you, Charles. Thank you, everyone, for joining us this afternoon for our third quarter 2019 earnings call.

Our profitability growth combination was once again demonstrated with a non-GAAP revenue of $654.4 million with a non-GAAP earnings per share that grew to a record $2.69. Services contributed approximately 15% of revenue.

We delivered non-GAAP gross margins of 64.4%, influenced by a solid performance from our cloud titan and enterprise verticals. In terms of customer trends, we registered a record number of new customers in Q3 and continue to drive this new customer logo expansion at the rate of one to two per day throughout the quarter.

For calendar 2019, we do expect to have two customers that will be greater than 10% of our revenue, Microsoft and Facebook. In Q3, the cloud titan vertical segment remained our largest one. The modern enterprise segment is now consistently becoming our second largest with financials in third place and service provider and tier 2 specialty cloud providers coming in at fourth and fifth place.

In terms of geography, in Q3, the international contribution was 19% with the Americas at 81%. In terms of new products, we introduced important enhancements to our CloudVision platform, the [ph] CloudVision 2019. Arista's CloudVision is bringing cloud principles to network operators across places in the cloud or PICs, as we call it. The largest cloud providers in the world have driven advancements in telemetry and automated network operations that improve many of the same network operations tasks for the enterprise. CloudVision ups the ante to deliver these analytic and telemetry capabilities to organizations in the enterprise of many sizes.

Key highlights of CloudVision 2019 include dynamic scale, elastic agility, deep visibility, and open integration where we can divide visibility metrics from SDK and SNMP-capable platforms including managing third-party devices to bring multi-vendor capabilities across the entire enterprise.

I would like to offer some further color on Q4 2019 guidance, given our significant drop. After we experience the pause of a specific cloud titan's orders in Q2 2019, we were expecting a recovery in second half 2019 for cloud titan spend. In fact, Q3 2019 is a good evidence of that. However, we were recently informed of a shift in procurement strategy with a material reduction in demand from a second cloud titan, reducing their forecasts dramatically from original projections for both Q4 2019 and for calendar 2020.

Naturally, this type of volatility brings a sudden and severe impact to our Q4 guidance. Given this tepid forecast and volatility of this cloud segment, we believe the cloud titan forecast should be modeled as flat to down in calendar 2020.

I do want to take an opportunity to reiterate that our market share for both 100-gig and overall high-performance switching remains solid and strong. We are proud of our strength in the enterprise and financial segment with growing success in our very first quarter of shipping Cognitive Campus portfolio products, which is now on track for $100 million in the first full year of shipments.

With that, I'd like to turn it over to Ita for more specific financial metrics.

Ita Brennan

Thanks, Jayshree, and good afternoon.

This analysis of our Q3 results and our guidance for Q4 2019 is based on non-GAAP and excludes all non-cash stock-based compensation impacts, certain acquisition-related charges and other non-recurring items. A full reconciliation of our selected GAAP to non-GAAP results is provided in our earnings release.

Total revenues in Q3 were $654.4 million, up 16% year-over-year and above the midpoint of our guidance of $647 million to $657 million. Service revenues remained strong, representing approximately 15.2% of revenue, down from 15.6% last quarter, reflecting typical seasonality of service renewals.

International revenues for the quarter came in at a $122.1 million or 19% of total revenue, down from 27% in the prior period. This volatility in geographical mix is largely driven by shifts towards U.S. deployments, in our cloud titan business. Overall gross margin in Q3 was 64.4%, above the midpoint of our guidance of 62% to 65%, and down slightly from 64.7% last quarter. This reflects the healthy cloud titan contribution combined with good performance from our enterprise and financial verticals.

Operating expenses for the quarter were $163 million or 24.9% of revenue, up slightly from last quarter at $158.7 million. R&D spending came in at a $.3 million or 16.1% of revenue, up from a $101.7 million last quarter. This reflected headcount growth and slightly higher levels of product-related NRE and prototype spending in the period.

Sales and marketing expense was $46.8 million or 7.1% of revenue, up from last quarter, with increased headcount somewhat offset by reductions in other sales costs. Our G&A costs were consistent with last quarter at approximately $11 million, or 1.7% of revenue. Our operating income for the quarter was $258.2 million, or 39.4% of revenue. Other income and expense for the quarter was a favorable $14.9 million, and our effective tax rate was approximately 20.5%. This resulted in net income for the quarter of $217.1 million or 33.2% of revenue.

Our diluted share number for the quarter was 80.75 million shares, resulting in a diluted earnings per share number for the quarter $2.69, up 27.5% from the prior year.

Now, turning to the balance sheet. Cash, cash equivalents and investments ended the quarter at approximately $2.4 billion. We repurchased a $115 million of our common stock during the quarter, at a weighted average price of $224 per share.

As a reminder, our Board of Directors has authorized a three-year $1 billion stock repurchase program commencing in Q2 ‘19. This program allows us to repurchase shares of our common stock opportunistically and will be funded with operating cash flows.

We generated $269 million of cash from operations in the third quarter, reflecting strong net income performance and a decrease from working capital requirements of approximately $25 million. DSOs came in at 63 days, up 51 days in Q2, reflecting the timing of billings in the period. Inventory turns were 3.1 times, up from 2.4 last quarter. Inventory decreased to $239.8 million in the quarter, down from $314.2 million in the prior period.

Our total deferred revenue balance was $529 million, up from $502.2 million in Q2. As a reminder, our deferred revenue balance is now almost exclusively services related with any significant product deferred revenue amounts having been recognized through the income statement in the first half of the year.

Accounts payable days were 31 days, down from 37 days in Q2, reflecting the timing of inventory receipts and payments. Capital expenditures for the quarter were $4.7 million. [Ph]

Now, turning to our outlook for the fourth quarter and beyond. We continue to experience significant volatility of demand from our cloud business. We saw strong recovery from the customer who had paused activity in the second quarter only to be surprised by a dramatic reduction in forecast for Q4 and 2020 from another key titan. All indications are these actions do not [indiscernible] positioning our share for Arista at these customers but will likely result in demand from this part of the business being flat to down on a year-over-year basis for the remainder of 2019 and into 2020.

While we're not at this point in a position to provide overall guidance for 2020, we did want to make the following points. Firstly, a recap on deferred revenue and its impact on 2019 results. As outlined in prior calls, we recognized $80 million and $38 million of non-Microsoft product deferred revenue in Q1 and Q2 ‘19, respectively. These amounts represented product sales, ships and bills in the prior year for which revenue was deferred, pending customer acceptance of legal redesigns and features. While not impacting our 2020 cash metrics, this does set up some tough comps for year-over-year revenue growth, particularly in the first quarter of 2020. At this point, we believe this trend combined with typical Q1 seasonality and the recent update to cloud forecast described above, may result in revenues for the first quarter of 2020 at approximately 5% [ph] Q4 ‘19 level.

On the gross margin front, we would reiterate our overall gross margin outlook of 63% to 65% with customer mix being the key driver. We will continue to manage investments in the business carefully with targeted growth in sales and R&D headcounts balancing the need to expand our market coverage with prudent financial management. Finally, you should expect to see us continue executing against the stock repurchase mandate in an opportunistic manner.

With all of this as a backdrop, our guidance of the fourth quarter, which is based on non-GAAP results and excludes any non-cash stock-based compensation impacts and other non-recurring items is as follows: Revenues of approximately $540 million to $560 million; gross margin of approximately 63% to 65%; operating margin of approximately 36%. Our effective tax rate is expected to be approximately 20.5% with diluted shares of approximately 80.3 million.

I will now turn the call back to Charles. Charles?

Charles Yager

Thank you, Ita. We’re now going to move to the Q&A portion of the Arista conference call. Due to time constraints, I'd like to request that everyone please limit themselves to a single question.

Question-and-Answer Session

[Operator instructions] Your first question comes from the line of Simon Leopold with Raymond James. Your line is open.

Q - Simon Leopold

Thank you very much for taking the question. I appreciate the added disclosures and details you've given us on this call. So, thanks for that. I wanted to maybe get a better understanding of the 2020 commentary, given that at least looking at CapEx as an indicator, or revenue for business lines like Azure and AWS seem to be encouraging, suggesting 2020 could be a better year in terms of the CapEx forecast going back double digits for the web scale guys. Just wondering how you think we should square your more cautious tone on the cloud relative to what looks like better capital spending trends and healthy revenue trends from the web titans? Thank you.

Jayshree Ullal

Thank you, Simon. Well, as I was trying to explain, our Q4 forecast is actually quite consistent with many of the cloud CapEx reported in recent calls, which is overall flat to down. There's a lot of volatility going on [Technical Difficulty] going down but the overall trend for Q4 is down, and we're projecting that same flat to down trend for CapEx next year for the overall cloud titan spend.

Now, one of the things that as you know, you may have remembered this, we were not tracking from a networking point of view in prior years [Technical Difficulty] cloud CapEx, nearly as nil --as well. So, there's not a one to one correlation. And in some cases, what we're seeing in the cloud CapEx is that redistribution to infrastructure, not to networking.

So, if you look at the two reasons why we believe it will slow down also in 2020, it’s because many of the cloud titan customers are extending their use of server assets and delaying the network purchase longer and buying other infrastructure or investing in other aspects. And the second is the 400-gig adoption. We had predicted initially that deployments could start as early as second half this year, we are shipping 400-gig products for initial trials this year. But, the initial deployments have shifted by more than a year to second half 2020. And we think mainstream production will be 2021.

So, the change in customers extending their investments and the deployment of 400-gig is causing us to be more muted about 2020.

Simon Leopold

Thank you very much for that.

Operator

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

Tim Long

[Technical Difficulty] If I could just follow up on the cloud titans again, maybe just a two-parter. Number one, could you talk a little bit about the customer that had the recent sudden change? And it seems it has a long tail to it as well. Any visibility as to why they're doing it, as their business is changing, or is it just as you said, just the spending is changing? And secondly, do you think this is a trend that highlights more -- even more than flat to down risks for some of the other large customers? Thank you.

Jayshree Ullal

Okay. So, specific to the cloud titan whose forecast reduced dramatically, I think, there were two main reasons, and I'm going to ask Anshul, our cloud expert and COO to elaborate. First is, they are managing the CapEx for networking and modulating the inventory and shifting to more of a just-in-time type forecast. So, typically, they gave us two-quarter visibility, sometimes even three and four, and now, they're moving much more to a real time forecast at quarterly intervals. And the second is, this particular cloud titan is extending their server assets [ph] by more than a year. And once the server assets get extended, that is significantly delaying the network spend too. Anshul, do you want to add to that?

Anshul Sadana

Jayshree, that’s absolutely right. The server request delay is specific decision for this one cloud titan, they didn’t see enough ROI in doing the request just right now, they might rate [ph] generation, and the impact we’re seeing as well, because they want to upgrade the network but they are not upgrading the server.

Jayshree Ullal

And so, to answer the other part of your question, Tim, on other cloud titans, we think some will be stronger, some will be flat, some will be weaker. But, the average all of that we see flat to down.

Operator

Your next question comes from Ittai Kidron with Oppenheimer. Your line is open.

Ittai Kidron

Hi. I guess, I want to follow up then on your recent explanation here, Jayshree. I mean, the CapEx moving to just-in-time, that shouldn't affect your business, you might not have visibility, but that still means business needs to come in, as long as you keep building. I guess, moving to the server refresh cycle, is that where the bulk of your business with that cloud titan was, and just kind of refresh upgrade of existing platforms, there was no new build with this customer?

Jayshree Ullal

Bulk of it was -- there is always multiple levels of connectivity. Bulk of it is obviously the first layer, you got to build servers for us to put a network. The second layer is usually regional sign [ph] and data center [Technical Difficulty]

Operator

Ladies and gentlemen, please stand by. We are currently facing technical difficulty. The conference will resume monetarily. Thank you for your patience.

Jayshree Ullal

Did you hear the answer, Ittai?

Ittai Kidron

Yes. If you could repeat it? I think, everybody got disconnected in the mail. I hope it wasn't something I said.

Jayshree Ullal

No. But, now I have to remember your question to repeat the answer.

Ittai Kidron

The question is, again, we are reiterating the question regarding the nature of your business with them, is it just tied to sever refresh, is there no new build, new greenfield build with them?

Jayshree Ullal

Yes. No. And the answer is, clearly don't start with -- if you don't have servers and storage, we can't connect with the network. So, the nature of our use cases starts with server spend correlated to network spend, which in turn creates layers of additional titans which can be the aggregation or the regional titans as well. But, that's the symptom, and the cause is more networking spend. Now, that doesn't mean they don't spend on new data centers. I think, the CapEx serves many of the cloud titans, including the one we're discussing, reflects that they will spend in a healthy fashion of the infrastructure for new data centers. But, to correlated that back to networking will take time. Because first they have to buy the new servers and then they have to buy the network, which could go well into late 2020 or 2021, most likely.

Ittai Kidron

Maybe as a follow-up, Microsoft just won the JEDI contract, what does that mean to you, how do you look at that and what it could do for your business?

Jayshree Ullal

We're very pleased with that. And as you can imagine, Anshul and the team work very hard on federal certifications and partnership with our cloud titan vendors. Having said that, the first thing that happens with these large contracts is they get contested. So, while the award may be given, we think it will be time for us to see material benefit, may take 6 to 12 months.

Operator

Your next question comes from Samik Chatterjee with JP Morgan. Your line is open.

Samik Chatterjee

Just moving beyond your commentary about the volatility and spending from the cloud titans, I just wanted to ask about the tier 2 cloud providers. It sounds like you have more visibility or more stability in terms of what you're seeing in terms of spending patterns from them. Is that fair, or if you can elaborate on what you see on that side? And does this kind drive you to focus more on that segment going forward?

Jayshree Ullal

Yes. Samik, thank you. While majority of our guidance was due to the specific cloud titan, you might have noticed in my commentary that both the service providers and the specialty tier 2 cloud providers came in at 4th and 5th place. I think this is the first time the specialty tier 2 cloud providers have been deadlocked. [Ph] And in my view, the segment is weak and the results have been mixed. I think, the new tier 2 company -- specialty cloud companies that started growing very well for us in 2017 and ‘18 are now having to review their investments and decide from a matter of economics which ones make more sense, do they rely on their own cloud or go to the public cloud titan. And some of the tier 2 companies are finding it difficult to compete, some are continuing with this strategy. So, it is a mix bag for us. And especially in Q4, we don’t expect much success from this category.

Operator

Your next question comes from Alex Henderson with Needham and Company. Your line is open.

Alex Henderson

I was hoping you could spend a little bit of time relative to this cloud issue. To what extent you are confident that there is no competitive incursion here that’s causing it, and in fact you have sustained share at that customer? How can we judge that, how do you get your arms around -- clarity around that point?

Jayshree Ullal

Alex, that’s a very good question. From our perspective, the competitive dynamics have not changed in the cloud or in general. We always have aggressive competition and we will continue to see aggression there. But, what gives us confidence, the cloud titans are delaying their spend or distributing their CapEx differently is as you know we always pride ourselves in close partnership and relationship with cloud titans. And generally, especially in the case of Facebook and Microsoft, they’ve been not only a vendor customer relationship but really a co-development that requires the kind of partnership which is engineering to engineering, not just business. So, when you look at that, there is no evidence that competitively or white box wise, there has been any change. There has been process change. There is better inventory management, there is better procurement, optimization et cetera. And you can always expect these cloud customers want to be multi-sourced but it isn't any different than we've seen in the past in behavior, relationship, in art, innovation. We have 10 400-gig products and a lot of them are in trials. So, relationship and the technology partnership couldn't be better. Anshul, do you want to add to that.

Anshul Sadana

Alex, we work very closely with these customers to a point that we're working on the 2021 roadmap along with these customers right now, and quite well aware of the changes they are making to the architecture as well, and have very direct feedback from customers as well that there is no alternate that's displacing us. It's simply that demand has gone down. And we are very confident of our share, when that demand comes back as well, since we collaborate with these customers. So, we're not worried about it and the customers are pretty direct as well. This is not our share going to someone else, their demand reduced.

Alex Henderson

Okay. Thank you very much.

Operator

Your next question comes from James Faucette with Morgan Stanley. Your line is open.

James Faucette

Thanks very much. Adding my pull-ups to the other questions that have already been asked. On this change in, architecture and strategy and what they're doing with their servers, is this related to how they're implementing servers and networking, obviously, by extension, so that we're looking at a permanent lengthening of replacement cycles, or is this somehow just related to the current cycle? I guess, I'm trying to get a sense for what the -- even as the customers come back, what the opportunity is and how we should think about the frequency that they'll need to come back and add additional capacity or upgrade networking equipment, et cetera?

Jayshree Ullal

Yes. Good question, James. You may know that several cycles tend to go in 18 months to three years. And generally, they get upgraded in that type of timeframe. In this particular case, because of the server vendor, and architecture -- the server vendor, there is no change in server architecture, and I have to emphasize that. They are choosing to delay this server -- new server deployment by at least a year. So, it’s no more, no less, no change in architecture, but really a delay of servicing, which is causing a delay in network spend.

Anshul Sadana

Great. And then, that has some short-term impact on the IO need from these servers. If there’s no new server, they may not need as much IO that they are planning on. But in the long run, these things do balance out, this is near term estimate, so one year type of cycle until they do start their refresh.

Operator

Your next question comes from Aaron Rakers with Wells Fargo. Your line is open.

Aaron Rakers

Thanks for taking the question. Maybe I'll shift gears a little bit. As you think about the model and the growth rates that you've outlined looking into next year, I'm just kind of curious, do you take a more active stance and kind of project -- protecting the margin profile the Company? And, how do I think about just the investments that the Company’s previously kind of alluded to that would be required to really position yourself for campus ramp as we move into next year. And just any kind of commentary on how you've seen campus thus far?

Ita Brennan

Yes. I'll take the model question and then, Jayshree can take the campus question. As we think about the business as we go forward, I think we believe we can operate hopefully in the plus or minus 35% operating margin model that we talked about for some time, and we talked about as far as the long-term model. We are guiding 36% for Q4, even with the kind of reductions in revenue, right. So, we do have some flexibility there. But, I think you have to probably expect that you won't see the 39% and 40% type operating margin numbers that we've been putting up more recently. So, we will continue to make investments that will be targeted. You'll see us continue to invest in sales and market side because we think that's important as we go forward, and on headcount et cetera and R&D as well. But we think we can still do it within that envelop.

Jayshree Ullal

And regarding campus, as I said in my opening remarks, we are marching well to the $100 million in shipments for the first four quarters. Q3 was our first quarter. What surprised me pleasantly on campus acceptance is half our customers are existing but half are new. If you were to ask me to forecast that, I wouldn't have embedded that. I would have thought 80% would be existing. So, we're really getting a lot of interest in our campus. In fact, I would say, one of the strong reasons our enterprise segment is number two is not only because of the data center, but small numbers in the campus in Q3 but I believe the two will influence each other, that we will become more relevant in the enterprise because of both, campus and enterprise, and the architectural shift that we can guide to public workloads versus private.

I think, when I look at why, we're very differentiated. The cognitive to us is really architectural, both on our Wi-Fi and POE switches and displaying the CloudVision. So, customers are really appreciating our differentiation on flow analysis, on security, on bringing an integrated cognitive, secure, software driven integration together much like we did with the data center. So, we like our early progress and execution there.

Operator

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

Alex Kurtz

Yes. Thanks. I have more of clarifications than a question. I just wanted to make sure we all understand that the account that's driving this downside here is not historically largest customer. And then, the second part of that is, given the disruption that you saw from Microsoft earlier in the year, I guess what's the context of their spend level as they go into Q4 and into the 2020?

Jayshree Ullal

Yes. So, just to clarify, Alex, it's the second cloud titan, it's not the one we mentioned the last time that had a Q2...

Alex Kurtz

Right.

Jayshree Ullal

And, specific to Microsoft, we're projecting -- we fully expect them to be a north of 10% customer concentration for 2019. And we expect to have a second new cloud titan customer which will be Facebook.

Alex Kurtz

And just into 2020 around Microsoft, just given the disruption we saw this year, Jayshree, how do you -- any early read on what kind of returning to more normalized spend in 2020 with them?

Jayshree Ullal

Anshul, do you want to say a few words?

Anshul Sadana

Sure. Alex, so far, we don't have a long-term guidance for Microsoft, but there is no, nothing different then they are on a usual spend pattern. So, we have not given any other than…

Jayshree Ullal

No blip, no pause, not yet.

Anshul Sadana

That's correct.

Operator

Your next question comes from Tejas Venkatesh with UBS. Your line is open.

Tejas Venkatesh

Thank you. As you reflect on the fundamentals technology drivers of bandwidth growth in the cloud that contributed to very strong growth over the years, has anything fundamentally changed? I asked because this year we have had sort of -- two different cloud vendors have some sort of hiccup. One was probably a public cloud vendor, the other content cloud vendor. So, completely different drivers and yet you're seeing the pause. [Ph] So, is there any sort of technology fundamental change?

Jayshree Ullal

Tejas, I don't see any fundamental change. I think, our strategy is in TAM is valid. I think, their strategy that they want to invest, has been very strong, the last four or five years. Perhaps the only change I would allude to is they are adding more process, more optimization, more care and feed into their forecasting, more discipline, more hygiene. But, I don't see any other change. I think, they continue to invest with scale and as you know they are all doing very well. But, that doesn't mean they will spend equally well.

Anshul Sadana

Tejas, the pause, as I mentioned, in Q2 was very tied to some internal financial planning for the customers and inventory planning, it was nothing to do with architecture or bandwidth and fund. And the second instance you're seeing right now there is the other cloud titan is with their server refresh. But when you model these out long-term there is no change in their growth expectations of traffic and networking need, both from a bandwidth standpoint as well as backbone and traffic engineering need. And with video storage and now AI workloads growing, there is always going to be more and more need for networking. So, we're not seeing that trend change. But obviously we have to wait for this customer come back and do the refresh.

Tejas Venkatesh

Thank you. And a quick follow-up, any change in enterprise spending? I realize your share of that market is lower, but are you seeing any deal elongation and so forth at all?

Jayshree Ullal

Too early. As you say, we are not the bellwether on enterprise. So, I think we understand the cloud much better. Because we are new entrant and we have new products, we're probably not the best indicator of change.

Operator

Your next question comes from Jim Suva with Citi. Your line is open.

Jim Suva

I have just one question. The change in the picture, strategy of this cloud titan, why won't it spread to both, other cloud titan and maybe even the second tier type cloud titan? Is there the risk of that or any visibility of why this challenge won’t spread? Thank you, Jim.

Jayshree Ullal

Thank you, Jim. I will comment and I will have Anshul elaborate. I think, the short answer is, no, we don’t see a lot of risk of that because anyway, visibility was two quarters. With this particular titan, they’ve optimized it to one quarter. So, if you were always relying on one and two-year forecast that would be a bigger dramatic change to our belief system and how we plan with them. But since it’s always been one or two quarters and a further refinement on this particular cloud titan customer to one quarter only, we don’t see a big change or big shift.

Anshul Sadana

And then, this is their own internal process and planning on how they plan networking purchases with respect to data center facilities going live. And they are optimizing their processing and their org, and fixing issues they might have had in the past. This does not apply to any of our other cloud titans. So, very specific organization issues in a company, not an industry trend or a technology trend.

Operator

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

Rod Hall

I wanted to just check what you're thinking on growth in 2020, I'm just playing around with the verticals here and thinking about what maybe you're implying with this. So, I wonder if you could put us in some sort of a ballpark for overall revenue growth. And then talk to us about why the down eight or so that you are implying in the guidance doesn't materialize through a better part of next year, so you end up with even lower revenue growth or maybe that's what you're already thinking. So, that's one thing. If you could just put us in some kind of a revenue growth ballpark for next year? And then, the other thing I wanted to ask is enterprise spending is clearly very weak. And a lot of the rest of this growth depends on enterprise. And so, I wonder if you could just update us on what you're seeing there. How much risk you think there is your enterprise numbers as we look into 2020, or at least early part of it with the slowdown that we're observing? Thanks.

Ita Brennan

Yes. I'll take the first part of that and then maybe hand out to Jayshree on the last part. I think from a model perspective, we're not yet trying to call a 2020 growth rate for the overall business. I think, we've tried to put some points out there and make sure everybody is aligned on some of the impacts from deferred et cetera. But, I think, as we enter the year, we will have a tough comp for the first quarter, particularly in the second quarter as well to some extent because of the deferred. We talked about the cloud vertical being flat to down. What we've seen pretty consistently is that the enterprise, part of the business and financial verticals have been growing well, and have been offsetting that, although not entirely, right? And we hope that that will continue, that we continue to see that. So, that's kind of an offset to the part of the business, which is really the cloud and service provider pieces, which have been used as we've gone through this year. I think Q1, I think we pretty much guided to Q1 number only because we want to make sure we reflect the deferred correctly, that we reflect the seasonality of Q1 and correcting them up.

Rod Hall

Okay. And then enterprise, if you want to -- can you tell us what?

Jayshree Ullal

Yes. On enterprise, I do believe from a demand and TAM perspective, we have a lot of opportunity for execution. And we could do very well, both in enterprise and financials. If we get affected by macro situations that affects everyone, not just us, so we would be influenced by that. But barring any macro situation, we feel very good about our execution to-date and going into 2020. And that'll hopefully offset some of the flatness in the cloud.

Rod Hall

Just coming back on the numbers. I mean, I…

Jayshree Ullal

Go ahead, Rod.

Rod Hall

Okay. Well, I was just going to say, I mean, it looks to me like it could easily be mid single digits growth next year. And I don't know if that's a crazy number from your point of view, or is that a plausible scenario?

Jayshree Ullal

I don't think it's a crazy number. We'd have to grow enterprise into significant double digits. I think at this point, we're not feeling strongly optimistic about the mid teens growth that we projected at the analyst day, because of how poorly cloud is doing. Right? Everybody else is -- and the enterprise and financials is doing well. But, how about you give us -- looking into Q4, Q1 and then will come back to you. We don't know.

Operator

Your next question comes from Amit Daryanani with Evercore. Your line is open.

Amit Daryanani

Thanks a lot for taking my question, guys. I guess a question of clarification. Just to ensure the entire $130 million revenue miss versus the [indiscernible], was that all attributed to this cloud titan customer shifting patterns or was that something else? That's one part. And then, secondly, maybe we could just touch on what you saw the enterprise side and do you think most of the a meaningful driver, revenue growth as you get into calendar 2020?

Jayshree Ullal

Yes. So quickly to answer your question, Amit. The specific titan was the absolutely the largest part of the gap and guidance. But, they were declines. As you know we've had a deteriorating declining performance in service provider, and new to the mix was a deteriorating and declining performance in tier 2 specialty cloud too. So, it was a combination of all three with majority being one specific cloud titan.

Now, specific to Mojo, Mojo is very much factored into our campus numbers, and we think the whole wired, wireless, cognitive, edge is really getting ignited with the Mojo product. We have completed our integration of CloudVision and Wi-Fi. Our distributed cloud managed Mojo is better than many of the standard controller offerings and legacy offerings in the market place. So we believe our campus is doing well and a good contribution from that is Mojo.

Operator

Your next question comes from Brian Young with Deutsche Bank. Your line is open.

Brian Young

Hi. Can you talk about what's changed on the 400-gig side? It sounds like the anticipated deployment for 400-gig have been pushed out one year from your initial estimate. So, kind of interested to get your view on what you think is causing those delayed deployments.

Jayshree Ullal

I think when we first began our 400-gig foray, you may have remembered, Andy Bechtolsheim spoke about it. We were always concerned, not whether we would have products and differentiated ones, which we do, we're shipping 10 types of products now, but whether the optics was ready and the ecosystem was ready. So, we thought the ecosystem would be ready by now and the optics have pretty much moved a year. Correct me, if am wrong, Anshul. So, by virtue of -- you cannot build 400-gig products and anything more than trials, if you don't have good optics to connect to it. So, by virtue of the 400-gig optics moving, we believe most of the initial deployments will move from second half this year, which is what we thought before, the second half 2020, which means production installations from thousands of ports to millions ports will really be 2021.

But I want to be clear that we are shipping 400-gig products. We're very proud of them. And as always, we are ahead of the industry.

Operator

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

Paul Silverstein

Two related questions, if I may. One, I just wanted to make sure I've heard you correctly, first before the question, which is, you said, two 10% could titan customers, Microsoft and Facebook for 2019, is that the same in terms of the time period?

Jayshree Ullal

Yes. That's correct.

Paul Silverstein

Okay. And you also said that the particular cloud titan question is the problem is shifted to one quarter from a two-quarter forecast, correct?

Jayshree Ullal

Well the forecasts were anywhere from two to four quarters, and they’ve now shifted specifically to one quarter.

Paul Silverstein

All right. Here are the two questions. One, with respect to the softness in 2020, putting aside 4Q ‘19, with respect to 2020, you made the point previously that with Microsoft, when you have that -- when they went [indiscernible] previously, you said the real question isn’t them coming back but to what degree. So, when you talk about the softness and significant decline in 2020, I presume they giving you that insight, notwithstanding the shift to one quarter forecast away from the previous two to four-quarter forecast. It sounds like they've given you visibility into next year.

Jayshree Ullal

That's correct.

Paul Silverstein

How much softness are you talking about or you’re expecting at this point? The other related question, somewhat different, but...

Jayshree Ullal

If you can allow me to answer that, Paul, and then we can get to the other question.

Paul Silverstein

Sure.

Jayshree Ullal

This particular cloud titan has not only given us a dramatic reduction for Q4 2019 but has given us a dramatic reduction for much of 2020. So, unless the other cloud titans, there is a pause and they come back and it’s more consistent, we fully expect this particular cloud titan to reduce next year significantly.

Paul Silverstein

Paul Silverstein

Then, on the broader question, 400-gig -- correct me if I'm wrong, but I think you made this point publically in the past that with respect to your business, selling inter-data center switches for at least fine [ph] top of rack, there is a 12.8 terabit upgrade cycle driven by new Broadcom silicon, Tomahawk and Trident as well as [indiscernible]. In that, if 400-gig optics aren't ready, the various cloud titans will buy the for hire capacity switches that you and Cisco and Juniper are introducing and just deploy them in high density 100-gig configurations until the 400-gig is ready and/or is at the right price points. That sounds like -- it sounds like you've changed your thinking on that.

Jayshree Ullal

No. There is no change in thinking that Jericho and Tomahawk, Trident will be used with higher capacity in 100-gig configuration. So, we will continue to see incremental deployments of that. No change there. But there won't be a wholesale change from 100-gig to 400-gig in this time until 2021.

Paul Silverstein

Jayshree, we can't ask to speak for your customers, that will be unfair. But does that imply that there's been -- maybe this is obvious, but doesn't that imply there is been a change in demand on the part of cloud titans in general to the extent that if the demand were there, again they are deploying 400-gig, would just deploy a lot more 100-gig and the impact to you as they switch vendor, it would be relatively nominal you won't see it, we won't see it. But it clearly appears that there is a general softness in demand.

Anshul Sadana

To your overall theme, we do very well and have good products that are 12.8 terabit, 128 by 100-gig switches. That point is well covered and customers do by that as necessary for their architecture. The dramatic change for one of the cloud titans is really coming from them delaying this for refresh with delays on network change that they otherwise would have done, which would have added more capacity. So, it gets delayed until they start that refresh, because these architects just go hand in hand. You don't touch the network and it goes independently, it goes together [indiscernible] whole architecture.

On the 400-gig side, the investor delays in general because seeing the entire ecosystem and many of the optics companies forgot about compatibility, which doesn't work with cloud companies because 400 has to work with two by 100 on the other side and so on. Otherwise you can't upgrade a large network and everyone is going through those motions to get the entire ecosystem ready, which will take at least a year before it starts getting the production.

Operator

Your next question comes from Jeff Kvaal with Nomura Instinet. Your line is open.

Jeff Kvaal

I guess, I clearly understand the downtick in cloud spending over the course of the next few quarters. And now we want to start thinking about what your comments mean about when we might come through the other side of that. It sounded as though 12, or 18, 24 months after a server refresh is over is a typical timeframe as you push it out six months for whatever reason that would strike me as being maybe in the fourth quarter of 2020, but more likely 2021 -- does that the mask kind of workout?

Jayshree Ullal

Yes. Jeff, I think, the reason we're saying the cloud titan forecast will be flat to down in 2020 is because any projections of optimism and growth is the earliest possible is Q4 2020. We're really thinking the impact to 2021 to get beyond this flat to down forecasts. And you're right a server cycle that's delayed by a year means it's a year from now, which means any impact to IO is a year from now, any kind of production deployment is over a year from now. So, I think 12 months is a good rule of thumb as a minimum.

Operator

Your next question comes from Sami Badri with Credit Suisse. Your line is open.

Sami Badri

Hi, thank you. I'm just trying to square away some of the commentary here. And to give you some context before my next question is that some of the third-party multi-tenant colocation providers have reported some of their strongest backlog quarters, all for data center capacity commencing in Europe in 2020. Now, the fair majority of those big bookings are actually being driven by cloud titan. So, as these cloud titans expand internationally, is there a difference in topology, architecture that is taking place because of the way they're building, the way they're connecting? That means that possibly alternative vendors would be more favorable, or is this just a completely different -- are we looking at something that is completely uniquely different than we've ever seen before?

Jayshree Ullal

Sami, typically, the cloud titans deploy us globally. As you know, we have a lot of international data center that they have built with us. And as they expand to additional data centers, the only difference is not architecture but size of the data center. So, depending on whether they're going into highly populated densities or smaller, they don't -- they will repeat the same architecture, but the scale and size may vary, which means they really, really wanted to be one uniform of architecture, ideally with one consistent software and one vendor. So, it is very rare to see that they will repeat it with a different vendor. So, I don't see any uniqueness in the international data centers except size.

Sami Badri

Thank you for that color. And then, just -- sorry, one follow-up on…

Charles Yager

Sami, we're running out of time here. Can we go to the next question, please?

Operator

Your next question comes from Erik Suppiger with JMP Securities. Your lines is open.

Erik Suppiger

Yes, thank you for taking the question. I just want to understand, if this issue with the Titans is beyond this one customer as you get into 2020, because it looks like you're reducing the outlook for Q4 by call it 20ish percent of revenue. And I'm not sure if we should carry that through and it seems like one customer who presumably is not 10%, why would we be cutting it that much? So is this more endemic across the broader titan universe or how should we be thinking about this?

Jayshree Ullal

I think what we're saying is our numbers are very large with the cloud titans. And we will do very well with some, the smaller ones, we may be flattish to down with the larger ones, depending on this trend. And when you cumulatively add all of this, it's going to be flat to down in revenue. I don't think it means -- it's not a trend for overall the next three to five years it’s a projection of what specifically will happen in 2020, especially because they’re going to, lift their servers, leverage their existing infrastructure, keep adding 100-gig to that, not quite move to 400-gig, we see 2020 as a transition year with our cloud titan in terms of high performance as well. So, I wouldn't read anything more to the forecast except for 2020, it will pick up later on.

Operator

Your next question comes from Tal Liani with Bank of America Merrill Lynch. Your line is open.

Tal Liani

Hey, guys. So, I want to understand just one thing. Most of the questions were asked, I want to understand, if you look at 2020 and you remove this one customer because next quarter you're going to have a down year, revenue down year-over-year, and I think you said also 2020. So, now I'm trying to understand if I remove this one customer that was really bad this quarter and provided this $120 million, $130 million shortfall, then what's the underlying growth of everything else? Is 2020 the story of one bad customer who is kind of rethinking strategy or is 2020 going to be down even if you remove that particular customer?

Jayshree Ullal

Well, loaded question. I think the way to think of this is, we have three types of cloud titans, some large ones that will main flat, some that will go down and some that will go up, and the aggregate of that is flat to down. Anshul, do you want to add it to that or did I get that right?

Anshul Sadana

That’s right…

Tal Liani

Right. I understand that's a very general answer. I mean, at the end of the daym, there is one big customer who is down $120 million off $670 million that's a giant number. So, we have to remove that to understand what's happening with the rest of it. So, when you do the math, is the rest of it is still up or its still going to be down?

Jayshree Ullal

First of all, remember, rest of it, we don't have hundreds of customers here, we have a handful. So, the cloud titans...

Tal Liani

There is still 550, right. The per quarter its still 550. I mean, it’s still meaningful, right?

Jayshree Ullal

I think we have to step back a little bit. It’s not like we have perfect visibility of what we think is going to happen in 2020 yet, right. I think what we're saying is what we have this issue with this particular customer, which is a large customer and has some significant impact. We have the rest of cloud, which has been unpredictable this year. That's the reality of life. We will see how it clears out next year, but sure we are not aggressively forecasting that right now, right? We have service provider, which hasn’t been performing well and we just saw, specialty cloud vertical is kind of go to the bottom of the it, right.

Offsetting that has been some good traction in enterprise and financials, and we saw them grow well in Q3, right. But, it's not enough to offset completely, which is why we say, the flat to down is significant for the rest of the business.

Operator

Your next question comes from George Notter with Jefferies. Your line is open.

George Notter

Hey, guys. Thanks very much. I know that you guys are making quite a bit of progress on the routing side. I know, there are a number of larger cloud provider customers that were looking into your routing products. Is that an opportunity for you to offset some of the softness you're seeing in the cloud side, is the incremental success with routing, any insight there would be great. And then one other clarification, if you could just repeat the deferred revenue metrics that you referenced earlier that would be helpful. Thanks.

Jayshree Ullal

Yes. George, you are very right. We are doing -- our strongest use cases for routing are with the cloud providers. So, beside all the several et cetera, these tend to be obviously stronger in value and fewer in number but we're doing very well with virtually all the cloud providers, cloud titans on routing. And we are doing very well in general in routing. It's improving for us on our landscape with tier 2 cloud providers as well in the routing use case specifically. So, we do look at that as an opportunity for next year as well.

Ita Brennan

And then just on the deferred, in terms of continuation from what we saw in the first half of '19. We have recognized $80 million in product deferred in Q1, $30 million of product deferred in Q2, that have basically been fixed and billed in the prior period. So, from a revenue perspective [indiscernible] Q1. From a cash prospective, it's different obviously because that deferred revenue didn't contribute cash for this year, but from a revenue perspective it's obviously higher bar.

Operator

Operator

Your next question comes from Hendi Susanto with Gabelli. Your line is open.

Hendi Susanto

I would like to understand more about the cloud titan phenomenon of delaying the use. Is there risk that other customers whether a cloud titan or not maybe have similarly, perhaps you can share some technical insight when a large customer to extend the use of server assets and when it cannot?

Anshul Sadana

All of those cloud titan customers have their own architecture and the choice of mix and the 25, 50 [indiscernible]. And if you look at the industry the cloud is actually not aligned to the exact same servers, CPU upgrade cycle, there offset from each other in a manner aligned with the [indiscernible] update from the industry as well. This particular decision does seem specific to only one titan, we have not heard this from anyone else and the others keep on adding capacity as they need. But this one customer for them, there wasn’t enough ROI, so they decided to delay their upgrade. So, I would just read it the way we have heard it from our customers and that was not [indiscernible].

Operator

Your next question comes from John Marchetti with Stifel. Your line is open.

John Marchetti

I just wanted to go back to comment and make sure that I heard you right Jayshree, when you were talking about the overall outlook for ‘20 ex the cloud business, if I go back to that analyst day presentation and how you guys talked about sort of cloud adding a few points growth to take you up into that sort of upper teens range. If we strip that out altogether for next year or even assume it's down a little bit, do we still consider the rest of the business ex that cloud still being in that sort of low double-digit to mid teens range? I just want to make sure I heard -- the way the you answered Rod’s question

Jayshree Ullal

Good question, John. I think just going back to the analyst day, what Ita said or Arista said more specifically, if the cloud did really well, would be in the high teens; if the cloud did average, would be in the mid teens. The current projections we're getting on the cloud is below that average that we thought was the norms. So with the new norm being flat to down, mid teens is off the table right now for 2020. Ita, do you want to add to that.

Ita Brennan

No. I think that's right. We hadn't contemplated the world at that point where cloud would be flat to down, just that we were contemplating we were kind of thinking between slowish growth and faster growth right. I don't think anybody in that space would have thought that there will be in the world where we would see that part of the business would actually be down to -- flat to declining.

Charles Yager

Thank you, John. We have time for one more question, operator.

Operator

Your last question comes from Andrew Vadheim with Wolfe Research. Your line is open.

Andrew Vadheim

Recognizing revenue pressures in 4Q and 2020, silver lining potentially could be through growth in other segments, maybe campus starts to ramp over the medium term, enterprise shows strength and maybe service provider recovers, and you would start to have more of a structural business to higher overall gross margin. Is that something that you perhaps just go ahead and embrace with more immediacy and invest faster and even more heavily in non-cloud, maybe the expensive cloud than previously would have anticipated?

Jayshree Ullal

You're right to point out that our business hasn't fundamentally changed. Our fundamentals are great. Our gross margins are 62 to 65. Our TAM is valid. We could grow in other places. But, I don't think we would want to forecast below -- beyond the 63 to 65.

Because I think we're in the band. If our cloud goes down, we should be on the higher end of the band. If our cloud goes up, we'll be at the lower end of the band. We don't see the band itself going up more. That being said, we're absolutely committed to R&D, we're absolutely committed to targeted hiring and investing. We think we can do that, like Ita said with a 35%ish operating margin. And so, no change in strategy in continuing to invest in R&D and sales and marketing, as well as M&A where it make sense to grow our other businesses and segments.

Charles Yager

Thank you, Andrew. That concludes the Arista Q3 2019 earnings call. Please note that we have posted a presentation which provides additional information on our fiscal results. which you can access on the Investors section of our website.

Operator

Thank you for joining, ladies and gentlemen. This concludes today's call. You may now disconnect.