Avgo earnings date 2018

Image source: The Motley Fool. Broadcom, Inc. (NASDAQ:AVGO)Q4 2018 Earnings Conference CallDec. 6, 2018, 5:00 p.m. ET Content: Prepared Comments Q&A Call participants Prepared Comments Comments: Operator Welcome to Broadcom Inc. Fourth and Fiscal Year 2018 Call for Financial Results Conference. At this time, for opening remarks and presentations, I would like to deliver the call to Beatrice Russotto, Director of Investor Relations at Broadcom, Inc. Please go ahead, ma'am. Beatrice Russotto -- Director of Investor Relations Thank you, trader and good afternoon to all. I am joined today by Hock Tan, President and CEO; and Tom Krause, Chief Financial Officer, Broadcom. After the market close today, Broadcom circulated a press release and accounts payable financially describing our financial performance for the fourth quarter and fiscal year 2018. If you did not receive a copy, you can obtain the information from the Investors section of broadcom's website at broadcom.com. This conference call is broadcast live and a recording will be available through phone playback for one week. It will also be archived in the Investors section of our website broadcom.com. During the prepared comments section of this call, Hock and Tom will provide details of the results of fiscal year 2018, guidance for fiscal year 2019 and some comments on the business environment. We will take questions after the end of the prepared comments. Please refer to our press release today and our recent submissions to the SEC for information on specific risk factors that could cause our actual results to differ materially from the forward-looking statements made in this call. In addition to the U.S. GAAP reports, Broadcom reports on certain financial measures on a non-GAAP basis. The tables attached to today's press release include a reconciliation between GAAP measures and non-GAAP measures. The comments made during today's call will mainly refer to our non-GAAP financial results. So, with that, I'm going to deliver the call to Hock. Hock Tan -- President and CEO Thank you, Bea, and thank you all for joining us today. Well, as you saw, we closed the fiscal year on a very high note. Consolidated net income for the fourth quarter of the '18 fiscal year was $5.45 billion, an increase of 12% over a year ago, and the EPS reached $5.85, up 27% from a year ago. Importantly, free cash flow was $2.53 billion, or 46% of our net income. I'd like to more color on the top line today, and I have a lot to cover today, actually. Note that fourth quarter results do not include any CA contributions. In quarterly results, from cabling, revenue was $2.2 billion, growing by 3% year on year, and a wired segment accounted for 41% of our total revenue for this quarter. However, the wired results of the fourth quarter reflect deeper, deeper results, strong year-over-year growth for our it and network download businesses, driven by strong demand from cloud data center markets as well as traditional businesses. Network and computing discharge accounted for more than two-thirds of our wired segment in the quarter and grew by 22% year after year in the quarter. This is after 10% year-over-year growth in the third quarter. Therefore, this part of the wired segment remains very robust. On the other hand, as expected, countercyclical winds in certain parts of our broadband business, reflecting weak carrier spending in those areas, continued to impact this part of our wired business in the fourth quarter. As a result, broadband fell back year after year in the fourth quarter and partially made up for strong growth in data center spending. In terms of enterprise storage, revenue was $1.3 billion, representing 23% of revenue. In line with what we experience in wired companies, strong enterprise IT spending exceeded year-on-year revenue growth by 96% in revenue. Now, of course, this includes contributions from Brocade, which we acquired about a year ago. But even if we removed Brocade, enterprise storage grew double digits year after year in the quarter. Turning to wireless technology, revenue was $1.7 billion, which was 5% year on year. The wireless segment accounted for 31% of our total revenue. Wireless revenue, however, was somewhat better than our expectations for the fourth quarter, as we benefited from upward volumes of legacy phone generations and our North American OEM customer. Finally, our last segment, industrial. In the fourth quarter, the industrial segment accounted for 5% of our total revenue. Distribution resale, which is the way we have been sold the industry, remained strong, contributing to high single-digit year-on-year growth in the industrial business. Now, let's talk about the performance of the segment for the full fiscal year 2018, which, interestingly, could be in stark contrast to the results of the fourth quarter I just articulated. Wiring for us in fiscal year 2018 to what year 1 down as networks expanded while broadband was down. Meanwhile, enterprise storage was significantly supported by Brocade, as well as strong organic growth in our server storage connectivity business. And the industry performed extremely well, 12%, aided by a healthy macro. Finally, despite all the quarterly fluctuations, the wireless connection actually went up by 20%. So, what's interesting and what I want to highlight when you move away from quarterly results and look at annual performance, we had a great year. Our revenue reached a new all-time high, growing by 18% year after year to nearly $21 billion for fiscal year 18. This clearly demonstrates how our diverse business suite drives stability and sustainability in our consolidated revenue, despite quarterly and even annual volatility in specific segments. With this in mind, we plan to plan quarterly guidance to annual guidance in the future. The annual goals and guidance reflect, we believe, more accurately how we manage our business and also aligns very well with the way the management and employees of this company are measured. In addition, by looking at our business in general, you can see that we have created over the years, organically and through acquisitions, a substantial core revenue stream in semiconductors based on connectivity solutions that enable technology in a broad set of end markets. We remain focused on the sustainability and growth of this core business. But also, with our acquisition of Brocade, we created a complementary revenue stream to our semiconductor solutions that we now call infrastructure software. With the acquisition of CAs, we will increase this revenue stream and build on it through acquisitions consistent with our business model. As a result, in the future, our two main segments will be semiconductor and infrastructure software solutions. And so, for fiscal year 2019, next year, the prospects for the business are as follows: In the semiconductor solutions segment, we expect continuous robust demand from cloud customers with next-generation Tomahawk 3 stretcher RAM and the launch of our next-generation routers, Jericho 2. We also expect the recovery of the spending of several operators on cable as well as communications, as we hope that the recovery of the broadband market will begin to progress throughout the year. We've seen that happen this quarter. We believe that storage will be stable in relation to fiscal year 2018. By reviewing the last quarter, we believe that the restoration of our wireless business in the first half of 2019 due to the loss of share in the current phone generation will be followed by a substantial recovery in the second half, as we regain participation for the next generation. So while there will be a lot of our push and take here, our perspective for the semiconductor business is for modest revenue growth in 2019. This can be somewhat dampened in relation to our expectation of long-term medium-unique growth by wireless. Now, turning to the infrastructure software segment. Before we provide our perspective, it should take a few minutes to describe the substantial changes we're making to the CA business model. We expect these changes to result in a dramatically more profitable revenue base that is more aligned with the rest of Broadcom and that we expect it to grow. First, the days of trying to new products with new customers, and I'm referring software, enterprise software. We are focusing our full attention on renewing existing products with existing mainframe-centric customers, customers representing virtually every largest company in the world, and largest IT spenders. We also target expansion opportunities within this mainframe core customer base. The cost of running this this and the expanded model will be substantially smaller than the legacy ground model at all costs, and more importantly, renew and extend the moves to CA's strengths. Let me explain. Today, more than 70% of CA's revenue is derived from its 500 main accounts. In almost all cases, these major customers have been licensing CA mainframe products for over a decade and often several decades. CA contracts with its customers are primarily broad-based multi-year licensing agreements and include a term license with mainframe maintenance. And for this same customer, enterprise products are sold as perpetual licenses with maintenance and data in license agreements. With each of our main customers we have two main objectives: 1.) We want to expand our mainframe efforts and make sure we are realizing the total value that our mainframe tools are delivering to our customers. And as discussed in a previous call, the usage defined by MITS has been growing at double-digit rates across all of these main accounts. Logically, we are now more focused, because of that, on consumption-based mainframe pricing. We also believe there's a great opportunity for customers to save money by leveraging our extensive mainframe portfolio to drive more conversions to CA tools. Moving on to the second target. We really want to expand our enterprise software products within these same main accounts. Now, it's true that lower costs and lighter SaaS alternatives have been creating challenges for CA for some time in the enterprise software market. But what's interesting is that CA actually has very highly qualified, in fact Gartner Magic Quadrant categories, for software in companies. While we are very well suited to the private cloud IT environment of larger enterprises, this enterprise software is too expensive relative to SaaS. Therefore, in the future, we will move from the uncompromising and perpetual licensing model for enterprise software to a license of everything you can eat across the enterprise for all of our core accounts. By doing this, we hope to eliminate the friction caused by the sale of expensive initial perpetual licenses so that incremental costs to our customers to expand the use of enterprise products are highly competitive relative to SaaS-based alternatives. In short, we are adopting a fully ratifiable subscription model for the Broadcom software business. This new business model, we believe, plays our strengths, focusing on the 500 largest mainframe-linked customers with the ability to a greater sale of enterprise software competitively using a base subscription model as much as you can eat. We hope that this transition, however, will take a couple of years, giving the time for contract renewals. But once completed, we expect revenue to stabilize at more than $3.5 billion annually and grow from there. And to support that revenue base, we don't expect to spend more than $900 million Year. And as a result, we expect to achieve more than $2.5 billion per year in operational profitability of the CA business once we go through this transition. We are underway today with the process of restructuring and integrating CA, including the announcement of Veracode's disinversion to Tomah Bravo and outsourcing the ca-to-HCL services business. So, with that as a background, let me talk about our perspective for the infrastructure software segment in 2019. Now, SAN switching. Private channel SAN switching here was made beyond our expectations in 2018 thanks to very strong business demand as well as significant stock gains. While we expect to continue to see healthy demand, we do not expect this to continue until 2019. In addition, as we are moving mainframe and enterprise software products to a fully ratifiable revenue recognition model and simply focusing on the top 500 accounts, we expect a restoration of CA revenue from the first quarter of 2019. As a result, our revenue outlook for the infrastructure software segment for 2019 will be approximately $5 billion. Combined with semiconductor solutions, in short, we are focusing consolidated revenues on approximately $24.5 billion in fiscal 2019. This will be, to some extent, driven by a very stable semiconductor business that will be complemented by an infrastructure software business that we are building quickly. Thank you. Tom? Tom Krause -- Chief Financial Officer Thank you, Hock, and good afternoon to you all. My observations today will focus mainly on our non-GAAP results of ongoing operations, unless specifically stated otherwise. Let me review our results for the fourth quarter of fiscal year 2018. Net revenue for the fourth quarter was $5.45 billion, ahead of the midpoint of guidance. Our gross margin of continuous operations was higher than our orientation was higher than our orientation by 68.4%, as we benefit from a more favorable product mix in the quarter. Operating expenses were slightly lower than expected, with $863 million. As a result, we achieved record profitability in the quarter. Operating income from continuing operations was $2.86 billion and accounted for 52.5% of net income. Adjusted EBITDA was $3.02 billion and accounted for 55.4% of net income. This figure excludes $132 million in depreciation, and the company delivered 5.85 EPS dollars in the quarter from a weighted average of $435 million fully diluted on a share account. represents 27% growth in SSPs compared to the same quarter last year. Working capital, excluding cash and cash equivalents, increased by approximately $105 million, compared to the previous quarter, mainly due to an increase in receivables. This increase was driven by seasonally higher shipments in the last month of the quarter. In addition, we spend $106 million on capital expenditures. As a result, we had a record free cash flow of trades at $2.53 billion, or 46% 46% Income. This represents a 47% growth in free cash flow compared to the fourth quarter of 2017. In the quarter, we returned $2.26 billion to shareholders, including $723 million in the form of cash dividends and $1.53 billion for the repurchase of AVGO's 6.4 million shares. We ended the quarter with $4.3 billion in cash, $17.5 billion of total debt, $408 million of shares outstanding and $432 million fully diluted. New, let me move on to our fiscal year 2019 non-GAAP orientation. We intend to update our annual guidance on our quarterly year-round earnings calls, and as usual, this guide is only for the results of continuous trading. As discussed with Hock, net revenue for fiscal year 2019 is expected to be approximately $24.5 billion, including approximately $19.5 billion from semiconductor solutions and approximately $5 billion from infrastructure software. IP licenses are not expected to generate a significant amount of revenue. Operating margins are expected to be approximately 51%. I would like to point out the post-CA restructuring, which we hope to approach operating margins of 55% by 2020. Net interest and other expenses are expected to be approximately $1.25 billion and reflect maintaining a target cash balance of approximately $4 billion and meeting the total outstanding debt of approximately $37 billion after the close of the CA transaction. This forecast does not cover debt payment in fiscal year 2019. The tax rate is expected to be approximately 11% and includes a slight negative impact on the acquisition of the competent authority. Depreciation is expected to be approximately $600 million. CapEx is expected to be about $550 million. As a result, the free cash flow from ongoing operations is expected to be approximately $10 billion. Finally, stock-based compensation costs are expected to be approximately $2.1 billion. Now, this is a substantial increase in our stock-based compensation expense, and let me take a moment to explain. We are implementing a special multi-year base equity awards program for our employees, including our new CA employees. Each multiannual capital prize will be awarded on the same basis as four annual capital grants made on 15 March each year, starting in 2019. A maximum of approximately 31 million common actions are expected to be published in vest over the next seven years Set. This is the same number of joint actions that we would have expected to grant in the next four years per year. The uptick in the 2019 value composition will begin to fall in 2020 and the decline from there to our normal level in 2022. So, in short, this really is an accounting dynamic that affects the composition of securities in 2019. We believe that providing four years of capital subsidies in advance provides clarity regarding future compensation that creates a powerful incentive for retention in a labor market long-term focus on shareholder value creation. In addition, it allows us to maximize the use of the remaining authorized share reserves under our Avago 2019 capital allocation plan, which unfortunately expires in 2019. As the ownership of broad-based employee shares is a critical tenant of our company, it is important that we continue with this legacy while our current capital plans allow us to do so. I'd notice a couple of things. 1.) Hock does not participate in this program and, as not previously disclosed, will not receive another capital subsidy until at least 2021. In addition, for executives 50% of the prizes are PSU, the award of which is linked to the total profitability of shareholders similar to our previous annual awards to executives. Finally, no further annual grants are provided for employees receiving this award at least until 2022. Now, let me move on to the capital allocation plans before opening the call for questions. In accordance with our capital allocation strategy, we focus on returning approximately 50% of our previous year's free cash flow to shareholders in the form of cash dividends, with the balance allocated to a combination of buybacks and stock acquisitions. In addition, we also plan to continue to use our balance sheet to finance acquisitions while focusing on maintaining our investment grade credit rating. With that, on the dividend, based on approximately $8.2 billion of free cash flow that we generated in fiscal year 2018, we are increasing our target quarterly cash dividend from this quarter to $2.65. This is a 51% increase. We plan to keep this year-round dividend payment subject to quarterly board approval, which means we plan to pay more than $4 billion in cash dividends in fiscal 2019. In accordance with our capital allocation policy, we will re-evaluate the dividend at this time next year based on our 2019 free tax cash flow from trades. Now, as dilution shareholders are leading to the multi-year subsidy and given the free cash flow yield Broadcom is currently generating, we are also budgeting to return an additional $8 billion to shareholders through share buybacks in fiscal 2019. Along with the dividend, this means that we are planning to return approximately $12 billion to shareholders in fiscal 2019, which constitutes all our projected free cash flow, plus the excess cash we have on our balance sheet today. With this I conclude my prepared observations. During the Q&A part of the today, please limit one question each so that we can accommodate as many analysts as possible. Operator, could you open the call for questions? Q&A: Operator Thank you. Ladies and gentlemen, if you have any questions right now, please press the * key and then 1 on your contact tone phone. Due to time restrictions, we ask that you please limit yourself to a question. If your has been answered or you want to get out of the queue, please press the key. Our first question comes from Vivek Arya with Bank of America Merrill Lynch. Vivek Arya -- Bank of America Merrill Lynch -- Analyst Thank you for taking my question, and congratulations on the good execution. Hock, I understand and appreciate keeping the focus on long-term trends, but only because removing guidance on a quarterly is a big change, just for this quarter, could you give us a little color on how first quarter trends are being set up, especially given all the concerns around trade and rates and their larger customers. So, even if you can't quantify everything, if you could give us some color comments about what's going on in different segments on Q1. That would be very useful. Hock Tan -- President and CEO I'll give you the opinion: Okay. That's more than a quarter, which lasts 13 weeks. Based on what we have in place, it's trending pretty well compared to Q4. And keep in mind, there are puts and takes even in all this. Broadband starts to recover, as I mentioned earlier, it finally lasts a long time. Networks, the download computing is still very well holding up. But wireless, you've seen it out there, we expect to see a seasonal low shot. Therefore, flat storage back to moderation. So, all combined, things are kind of like what it is. Not bad. Operator Thank you. Our next question comes from Aaron Rakers with Wells Fargo. Aaron Rakers -- Wells Fargo -- Analyst Thank you for accepting the question. I want to understand maybe the puts and take a little better in the software - infrastructure software guide. If you look at THE CA results independently, it looks like it's about 3.5 -- call it 5 billion. You're stripping the service business. You sold Veracode. So can you help us save a little more of the increase you're seeing from that income level to that year-round $5 billion guide? Thank you. Tom Krause, CHIEF Financial Officer Hey, Aaron. I'm Tom. I think, keep in mind that there are now two substantial businesses -- I really should say three in that number. As you correctly pointed out, there is the CA business for a couple of data points. Veracode's execution fee business is about $150 million a year and was growing. We've outsourced the services business, so the business will start continuing throughout 2019 and will largely disappear by 2020. But then keep in mind too, there's Brocade, the SAN Fibre Channel switching business, which is working very well for us. We're not breaking down specific revenue for that particular business, but it's also providing a portion of the total $5 billion. Therefore, in total we see a reset in the CA business starting with Q1. We expect, based on renewal expectations around our 500 customer base year-round with AC, and we also look forward to continuing to maintain reasonably high levels of revenue with the Brocade Fibre Channel business. Operator Thank you. Our next question comes from Amit Daryanani with RBC Capital Markets. Amit Daryanani -- RBC Capital Markets -- Analyst Thank you for taking my question, guys. When I think about that $2.5 billion AC operating profit target, can you talk about that schedule to achieve that? And when I look at the incremental attribution or contribution you get from CA, the accretion I guess, how much of that is going to come in cost versus OpEx for you? Hock Tan -- President and CEO Well, very interesting question. Let me outline again what I have been through in my remarks quite quickly. As Tom actually articulated earlier in response to a question, we started 2019 in part due to a restoration of perpetual license recognition in a manner associated with ratable subscription-based revenue recognition. The 19th will reduce what you normally expect the rate to be, and will accumulate quickly over the next two or three years to the level as we speak more than $3.5 billion. On the spending side, if you remember, before we acquired CA last quarter, stripping away services -- eliminating services that were laundering -- total spending was about $2.4 billion to $2.5 billion a year. We're lowering it to $900 million. Why we can reduce it to $900 million is what I've purposely articulated in my initial observations. A large part of that $2.4 billion expenses was attributed to the diverse sales motion, development move I must say, of trying to land new customers, as well as landing existing customers with new products, but basically landing new customers. And many of these customers are, I think, the long queue of a long list of customers. The 500 largest customers in the world are already our customers through mainframes. But a lot of that spent, I guess what we're saying is for more than $1.5 billion at least -- sorry, spending $2.4 billion -- sorry, $900 million is the end, so $1.5 billion is used to try to develop new products and land new customers. By moving away from that, focusing on the 500 largest customers, we've renewed most with mainframes, but rising sales of enterprise software. Basically we reach the same number of incomes with much less spending, substantially. And that $3.5 billion, let's say conservatively we arrived in year two or year three as of today, minus the $900 million end-of-state spending is where we believe we came to around the $2,500 operational profit target Operator Thank you. Our next question comes from Toshiya Hari with Goldman Sachs. Toshiya Hari -- Goldman Sachs -- Great Analyst. Thank you so much for taking the question. Hock, you spoke of your intention to regain participation in RF next year. I think that's consistent with what you said three months ago. I appreciate the time you spend with your customers and design these products, and you probably have some visibility, but I was under the impression that the SKUs for next year hadn't been established. So, I guess the question is, what gives you the confidence that you can really get back the part of that business? Thank you. Hock Tan -- President and CEO We're safe. And obviously, we haven't been idle. We've been working. Because these are very difficult products -- very complex, technologically advanced products to make, and we've been working on it for over a year with customers. Operator Thank you. Our next question comes from Harlan South with JP Morgan. Harlan South -- JP Morgan -- Analyst Good afternoon. Thank you for taking my question. Mr. Hock, you talked about prosecutor 19's continued strong trends in demand for networks, the cloud, and the company. I was hoping you could quantify a little more. You know, next year it still looks like the cloud kids are growing their expenses again, albeit at a lower rate compared to this year, but then you're around the 200-400 gigas upgrade cycle with Tomahawk 3 and then you have the ramp for some of your AI and deep learning programs and SmartNIC ASIC. Considering all this, I wanted to know if the team still feels they can sustain double-digit growth rates year after year for this '19 fiscal segment? Hock Tan -- President and CEO Very good question. Thank you. Yes, the public cloud I call it part of our network, the process download business, so to speak. The public cloud side, which is about half or at least half of our revenue at the moment in that sector that networks and offs downloads computing remains extremely strong. And he's strong, not for anything else. In 2018, we didn't launch any major milestone products, and we're still growing. As we indicated, we grew double digits. 2019, we also have that natural boost, adding the fact that we are launching two significant products. The top-of-rack switch, the Tomahawk 3, 12.8 terabytes per second, three-port switches that are very welcome, very -- will basically be very useful for hyper-cloud kids. That's going to be a great growth engine. In addition, perhaps in use in some of the backbone architectures of those hyper-cloud data centers, but tighter on operators for their routing applications, we are launching Jericho 2 mid-year. So, we have two product drivers on top of the natural drive to increase the content we're seeing, that you articulated, in those cloud data centers, from computer download, where we're talking about more than drivers. We're talking about deep learning content. We're talking about compression, encryption. And we're just talking about anything that has to do with downloading CPU cycles from servers. And that's a very long-term tailwind that we've basically been able to take advantage of and continue to benefit through probably over a year. Operator Thank you. Our next question comes from Romit Shah with Nomura Instinet. Nomura Instinet -- Analyst Yes, thank you. Tom, I just want to make sure I have my right facts on the options scholarship. So, $2.1 billion for fiscal year 19, and you have that coming up, is it in a four-year period? And you go back to tax levels 18 or some level above that? Thank you. Tom Krause -- Chief Financial Officer No, I think that's the right way to think about it, Romit. It is an accelerated four-year grant made in a single take this year rather than for four years. So, together, it wouldn't make any difference, but from an accounting perspective, you'll have to take the full step forward this quarter. He'll start bleeding next year and slow down again to where we've been for a four-year period. So, I look at the 2018 $300 million quarter execution rate rate of the value base composition as the execution rate approximately for the company on a stable basis. Operator Thank you. Our next question comes from William Stein with SunTrust. William Stein -- SunTrust -- Great Analyst. Thank you. Congratulations on the quarter. Thank you for taking my question. I'm particularly focused on the dividend. There was a significant increase this quarter, and when we looked at the company's ability to grow the long-term top line, expand margins and its capital allocation plans save more M&A, which management expects the long-term growth rate of that dividend? Tom Krause -- Chief Financial Officer, Will. I think we have written it quite clearly both in politics in terms of returning 50% of the free cash flow from the previous fiscal year. And we've now spelled out what we think we can do from a free cash flow from a trading perspective in 2019, which is $10 billion. Therefore, when you consider the expectation of buyback that we have also articulated of approximately $8 billion, standing stocks should go down, as well as free cash flow will rise. So when you do those maths, you're going to reach a number that's north of 20% in terms of dividend growth potential. Now, in the future, we will have a couple of other tailwinds that we have benefited from in the past, which is frankly M&A and the acretion we drive once we are fully integrated and restructured. And so, as Hock has been when we reach $2.5 billion more operating profits, that's going to start in 2020, until 2021, with no mergers and additional special visits, we would continue to focus not only on the dividend, but also on buyback, which would allow us to reduce the share count, too. So, I think we have a good to continue to be able to push the dividend well into the double digits in the coming years. Operator Thank you. Our next question comes from Stacy Rasgon with Bernstein Research. Bernstein Research -- Analyst Hello, guys. Thank you for taking my question. I was wondering if you could elaborate a little on the model of everything you can eat that you're developing now for the enterprise software business. Does that basically work a license that a customer takes for anything you buy in the future and put in that segment? And if that's true, how do you grow your business without raising those rates over time if you keep selling to the same customers? What does that model look like over time? Hock Tan -- President and CEO Oh, yes. That's a very good point. You're right, we provide that company-wide license to those core customers only, by the way, product by product. Obviously, it's not in all our business products at the same time, but it's only when the customer is adopting it. So, that part of it becomes very important, you're right. If a customer is one of those big core customers, he adopts to say agile operations -- one of our agile operations, software or agile what we call Rally, which is for projects, and they want more seats -- they want more capacity, what we'll provide is a multi-year licensing agreement. We expect to get a certain amount of dollars, as you say, and we will give you under that unlimited company right license. And you're right. Therefore, for that particular product, the limited ability to increase, except in the fact that after saying, the contract is three years, the end of three years of inflation improvement and improvement in a product, innovative improvement and putting more characteristics into the product. But we'd better sell them another project on the same basis. And that's how we hope to grow. Therefore, from two fronts: Improve the product we have continuously, but also sell the customer another product from a very broad set of enterprise software products. Operator Thank you. Our next question comes from Craig Ellis with B. Riley FBR. Craig Ellis -- B. Riley FBR -- Analyst Thank you for taking the question. I will echo the congratulations on the good execution. Tom, I think it was in your comments that you mentioned the aspiration of 55% operating margins in fiscal year 20. But since that would represent an increase of 400 basic points from what is being addressed in fiscal year 19, can you guide us through some of the assumptions that could raise the level of operating margin of that magnitude? Thank you. Tom Krause -- Chief Financial Officer yes, good question. So, there are a number of things with that. I think first of all, we still see the to grow the business. In the core semiconductor business, we do expect, especially as a in the back half, to see a return to more standard single-digit growth rates in 2020. On the software side, as we continue to grow in the ratable model, we also look forward to continuing to see growth there in 2020 and until 2021. And then, as is consistent with what you've seen in recent years, our model is very focused on the expansion of gross margin. We will continue to drive the incremental expansion of gross margins, especially on the semiconductor side. And finally, we've talked a lot about it in this call, but we're going to reduce spending dramatically with CA. And we're doing it because of a change in business model and focus on the top 500 accounts, the focus on leveraging the mainframe with these excellent enterprise products, and moving on to a fully ratable model. This is a much lower, much more profitable way to run the business. And so, you're going to see the benefits of that in 2020, which will actually continue to show progress even until 2021, I think. Therefore, 55% of operating margins we believe is very achievable as a result of all those factors, as we look beyond '19. Hock Tan -- President and CEO and to be specific, Craig. This '19 prosecutor, when we buy a company, especially as complex and large as CA, takes us a year or two to move on to the final state. Prosecutor '19, I would estimate that we carry something like a billion dollars of transition expenses in fiscal year 19 alone. Now, not everything will evaporate for fiscal year 20, but a large part of it will evaporate in fiscal year 20. And that, with the increase in revenue Tom was talking about, brings us to that 55% operating margin. Operator Thank you. Our next question comes from Craig Hettenbach with Morgan Stanley. Craig Hettenbach -- Morgan Stanley -- Analyst Yes, thank you. Hock, just one question. Any particular feedback from big customers now that you have Brocade and CA together? Is there anything you would like to discuss in terms of some of the synergies and overlapping of the customer base and the things you can do? Hock Tan -- President and CEO Big Question. Yes, I've met with quite a few IAAs -- chief operating officer and CIO of some of CA's largest customers, who turn out to be, coincidental or otherwise Brocade's largest end-end customers, too, which is SAN switching. And you may know, we mentioned in previous quarters, SAN switching, which is connecting to storage arrays, is very, very connected to mainframes as well, in hardware and storage in the way storage is done. And basically, all these IADs, many of them, are, as you well know, thinking about the high levels of IT spending that each they have to pass. Each of them is trying to figure out what is the best structure, architecture for their data centers. And many of them are regulated, which means they can't go completely to the cloud. So many of them go -- they're about... We all hear hybrid cloud. Many more of them are thinking of building their own private cloud. We have all the technologies, hardware and software, to allow them to build those private clouds. And each of those IADs in these larger companies that are spending at least several billion dollars on IT is quite capable and has the ability to do so. Therefore, there are potentially a lot of synergies, and it is not only in the technologies that we have and collaborate as one. It is also the market model that will be greatly simplified, since we now reach those end customers who are in CA, who are in Brocade, and who can indirectly develop the construction or purchase of large data centers, computer storage, networks indirectly from us. Therefore, there are many synergies, and we have begun the process of participating in a dialogue. Operator Thank you. Our next question comes from Vijay Rakesh with Mizuho. Vijay Rakesh -- Mizuho Values -- Analyst yes, hello guys. Hock, you mentioned the model of everything you can eat for the software. I wondered if you keep doing more on the software side that you can stack on that same model? Thank you. Hock Tan -- President and CEO It's a great idea, and we definitely want to do it, because we developed the platform with CA. That support platform, ensuring customer success, and a platform to play directly, participate -- in fact, play a lot, they call it, on those 500 larger customers. And as we add more products, software products, particularly enterprise software, we believe this is an opportunity for us, as we say, to leverage that second revenue— a complementary revenue source in infrastructure software. Operator Thank you. Our next question comes from Ross Seymore with Deutsche Bank. Ross Seymore -- Deutsche Bank -- Analyst Hello, guys. Congratulations, especially on the cash back side. Hock, I wanted to ask a bigger question. With all the uncertainty in China's trade and macro, et cetera, you have mentioned that you are 18 weeks behind us and that the first quarter, I think, is doing well, to paraphrase what you said. Have you noticed any changes in any of the various end markets that have given these uncertainties in customer behavior in any way, form or form? The President and CEO Oh yes, I'm sure it is. But I am not sure whether some of it is more related to the macroeconomic variations in these niches of market with which we deal with the greatest concern regarding tariffs is what I think it refers to. It's hard to tell. But as we said, we're in so many different end markets, niches of some of them, we see some of them. Your question is, are you all constantly on a downward trend? Lol We don't see it. But we see some that are below, and we see some that are upstairs. Is that an indication that they are tariffs against a very typical macroeconomics? I really don't know. Know. of the color I've given you guys are hardly affected by them. For example, broadband recovery -- I think it's more tied to the bulge and business cycle and investment of operators, especially in Europe and the United States more than anything else, and we're benefiting from it. Meanwhile, cloud spending, whether in the United States or China, remains unchanged. It's still going really well. Companies, maybe we'll start to see some level of slowdown in businesses, but that's only a small part of our broader system. So, it's a lot of mixing. At the end of the day, it is still not as clear how this will affect the business we are in, which is largely companies and operators. Our consumer exposure is limited to that pair of high-end phones, and in that sense, as we've all seen, the phone market hasn't exactly been very strong these last few months. Operator Thank you. Our next question comes from John Pitzer with Credit Suisse. John Pitzer -- Credit Suisse -- Analyst Hello. Many of my questions have been answered. But, Hock, just to follow Ross' question. You made some comments about cloud/hyperscale, and that's clearly an area where I think growth has been particularly strong this year, and there are some distressed investors about whether or not from these high levels that can be sustained in '19. I'd love to get your point of view on that, and when you answer the question, I'd love to get some kind of differentiation between the type of your core Ethernet business and maybe some of your new emerging ASIC businesses you have with the hyperscale guys, especially around the acceleration in AI and how that's happening. The President and CEO of Ok, two questions. Let's try the first one. The cloud kids, as we say, spending is still going on. I mean, your spending pattern, to some extent, is almost starting to track or copy those of the operators. They get bulging. They do not extend evenly over a year. But if you take that, that's part of the reason we want to go to an annual thing. Because if you do it quarterly, it's not driving me crazy, it's driving them crazy. Because it gets very bulging, especially with the level of spending that everyone is entering and the level of spending they make on our products. But if you look at it over a one-year period, they're holding it. And they're holding, and I'm really talking about the big types of the cloud, which includes both China and the US, but also the Tier 2 guys. It's still holding. And part of her is happy too. We're selling them more and more things, as we say, products. It's not just changing and, to some extent, routing, it's just the change we started with initially, which is what I highlight, and it's not a new generation of switching as they're going to scale out data centers and higher-capacity switching. We sell interconnections interconnections fiber optics, and as it goes from 10 gigabit to 100 gigabit, now 100 to 200 and 400, the price point - the content of those optical fibers soars quite exponentially and very well. So, we also do this computer download, which is really a good description or a broad base of, as I say, you call it accelerators. And it's true, they're mostly accelerators and deep learning chips, network Ethernet controllers, SmartNICs as some people call them, encryption, compression, video deliveries, chips, everyone who comes in. Content continues to grow. And that's why there's some level of when you do it all together, where do you see the cloud going? And as I said, most of these are not one generation or one year at a time; go beyond a year. So, in general, we see it as a continuum that is growing. How fast does it grow? That's that 20% I mentioned in the fourth quarter. It seems unusual, but it's because of the bleosity, and that's why we don't want to give them the wrong impression, because the quarter before it was closer to 10% and on average, I would say that the cloud guys grow more likely in the individual high digits to 10% year by year than 20% than any particular quarter could induce us to think. So, but it's very stable, and it's there to replace, to some extent, companies - traditional companies. Operator Thank you. Ladies and gentlemen, we have time for one last question, which will come from Timothy Arcuri with UBS. Timothy Arcuri -- UBS -- Analyst Hello, thank you. Tom, I'm just trying to get some kind of apple-to-block bridge at $24.5 billion relative to the $23.9 that was shown as a pro forma in the filing for the CA deal. I know you're losing Veracode and you're losing some of the stuff around HCL, but you're also getting hit by the change in the model in the software business. So I'm trying to get a bridge in the apples to the apples at that $24.5 relative to that $23.9 you showed at the presentation. Thank you. Tom Krause -- Chief Financial Officer It's a challenging bridge, just because you're talking, first of all, about two accounting standards with 605 versus 606 on the AC side. But the way it was, I think the right way to think about it is $24.5. We've talked a lot about where we think semiconductor growth will be. It's a new way of informing us, but we think we're going to have modest growth on the semiconductor side. And then you have two businesses. You have CA and Brocade, which make up the $5 billion we're building on the infrastructure software side. So, we're pretty comfortable based on modest semi-growth, and we've articulated I think how we got there at the end of what at the end of the day is a solid Brocade business plus a restructured and re-established CA business, and that's how we got to $24.5. Operator Ladies and gentlemen, thank you for participating in the This concludes the program. You can disconnect and have a wonderful day. Duration: 61 minutes Call participants: Beatrice Russotto -- Director of Investor Relations Tom Krause - Chief Financial Officer Hock Tan -- President and CEO Vivek Arya -- Bank of America Merrill Lynch - Analyst Aaron Rakers -- Wells Fargo -- Analyst Amit Daryan RBC Capital Markets -- Analyst Toshiya Hari -- Goldman Sachs -- South Harlan Analyst -- JP Morgan -- Romit Shah Analyst -- Nomura Instinet -- Analyst William Stein -- SunTrust -- Stacy Rasgon Analyst -- Bernstein Research -- Analyst Craig Ellis -- B. Riley FBR - Analyst Craig Hettenbach - Morgan Stanley - Analyst Vijay Rakesh - Mizuho Securities -- Analyst Ross Seymore -- Deutsche Bank -- Analyst John Pitzer -- Credit Suisse -- Analyst Timothy Arcuri -- UBS -- Analyst More AVGO Analysis This article is a transcript of this conference call produced for The Motley Fool. 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