CISCO SYSTEMS, INC.
Form 10-Q
November 20, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 27, 2012
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 0-18225

CISCO SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

California (State or other jurisdiction of incorporation or organization)	77-0059951 (I.R.S. Employer Identification Number)

170 West Tasman Drive
San Jose, California 95134
(Address of principal executive office and zip code)
(408) 526-4000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

Number of shares of the registrant's common stock outstanding as of November 15, 2012: 5,309,248,366

Cisco Systems, Inc.
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PART 1. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)
CISCO SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except par value)
(Unaudited)

	October 27, 2012	July 28, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$4,773	$9,799
Investments	40,227	38,917
Accounts receivable, net of allowance for doubtful accounts of $224 at October 27, 2012 and $207 at July 28, 2012	3,942	4,369
Inventories	1,709	1,663
Financing receivables, net	3,726	3,661
Deferred tax assets	2,253	2,294
Other current assets	1,277	1,230
Total current assets	57,907	61,933
Property and equipment, net	3,409	3,402
Financing receivables, net	3,695	3,585
Goodwill	20,443	16,998
Purchased intangible assets, net	3,449	1,959
Other assets	3,740	3,882
TOTAL ASSETS	$92,643	$91,759
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	$55	$31
Accounts payable	889	859
Income taxes payable	200	276
Accrued compensation	2,710	2,928
Deferred revenue	8,721	8,852
Other current liabilities	4,539	4,785
Total current liabilities	17,114	17,731
Long-term debt	16,272	16,297
Income taxes payable	1,577	1,844
Deferred revenue	3,902	4,028
Other long-term liabilities	1,077	558
Total liabilities	39,942	40,458
Commitments and contingencies (Note 12)		
Equity:		
Cisco shareholders’ equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	—	—
Common stock and additional paid-in capital, $0.001 par value: 20,000 shares authorized; 5,311 and 5,298 shares issued and outstanding at October 27, 2012 and July 28, 2012, respectively	39,290	39,271
Retained earnings	12,563	11,354
Accumulated other comprehensive income	833	661
Total Cisco shareholders’ equity	52,686	51,286
Noncontrolling interests	15	15

Total equity	52,701	51,301
TOTAL LIABILITIES AND EQUITY	$92,643	$91,759

See Notes to Consolidated Financial Statements.

CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per-share amounts)
(Unaudited)

	Three Months Ended	
	October 27, 2012	October 29, 2011
NET SALES:		
Product	$9,297	$8,952
Service	2,579	2,304
Total net sales	11,876	11,256
COST OF SALES:		
Product	3,748	3,563
Service	889	803
Total cost of sales	4,637	4,366
GROSS MARGIN	7,239	6,890
OPERATING EXPENSES:		
Research and development	1,431	1,375
Sales and marketing	2,416	2,452
General and administrative	560	552
Amortization of purchased intangible assets	122	99
Restructuring and other charges	59	202
Total operating expenses	4,588	4,680
OPERATING INCOME	2,651	2,210
Interest income	161	164
Interest expense	(148)	(148)
Other income (loss), net	(33)	19
Interest and other income (loss), net	(20)	35
INCOME BEFORE PROVISION FOR INCOME TAXES	2,631	2,245
Provision for income taxes	539	468
NET INCOME	$2,092	$1,777
Net income per share:		
Basic	$0.39	$0.33
Diluted	$0.39	$0.33
Shares used in per-share calculation:		
Basic	5,301	5,394
Diluted	5,334	5,407
Cash dividends declared per common share	$0.14	$0.06

See Notes to Consolidated Financial Statements.

CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions)
(Unaudited)

	Three Months Ended	
	October 27, 2012	October 29, 2011
Net income	$2,092	$1,777
Available-for-sale investments:		
Change in net unrealized gains, net of tax benefit of $1 and $26 for the three months ended October 27, 2012 and October 29, 2011, respectively	4	(53)
Net gains reclassified into earnings, net of tax effects of $10 and $2 for the three months ended October 27, 2012 and October 29, 2011, respectively	(17)	(6)
	(13)	(59)
Cash flow hedging instruments:		
Change in unrealized gains and losses	66	(50)
Net losses reclassified into earnings	5	—
	71	(50)
Net change in cumulative translation adjustment and other, net of tax (expense) benefit of $(10) and $21 for the three months ended October 27, 2012 and October 29, 2011, respectively	114	(211)
Other comprehensive income (loss)	172	(320)
Comprehensive income	2,264	1,457
Comprehensive loss attributable to noncontrolling interests	—	7
Comprehensive income attributable to Cisco Systems, Inc.	$2,264	$1,464

See Notes to Consolidated Financial Statements.

CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(Unaudited)

	Three Months Ended	
	October 27, 2012	October 29, 2011
Cash flows from operating activities:		
Net income	$2,092	$1,777
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and other	612	621
Share-based compensation expense	306	341
Provision for receivables	29	(13)
Deferred income taxes	135	109
Excess tax benefits from share-based compensation	(15)	(21)
Net losses (gains) on investments	15	(13)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	615	399
Inventories	42	(168)
Financing receivables	(132)	(9)
Other assets	99	(374)
Accounts payable	(19)	36
Income taxes, net	(372)	(38)
Accrued compensation	(359)	(548)
Deferred revenue	(295)	232
Other liabilities	(288)	2
Net cash provided by operating activities	2,465	2,333
Cash flows from investing activities:		
Purchases of investments	(8,213)	(11,770)
Proceeds from sales of investments	2,447	7,721
Proceeds from maturities of investments	4,388	1,179
Acquisition of property and equipment	(265)	(265)
Acquisition of businesses, net of cash and cash equivalents acquired	(4,912)	(38)
Purchases of investments in privately held companies	(9)	(153)
Return of investments in privately held companies	12	58
Other	22	77
Net cash used in investing activities	(6,530)	(3,191)
Cash flows from financing activities:		
Issuances of common stock	117	203
Repurchases of stock - repurchase program	(183)	(1,744)
Shares repurchased for tax withholdings on vesting of restricted stock units	(203)	(137)
Short-term borrowings, maturities less than 90 days, net	23	—
Excess tax benefits from share-based compensation	15	21
Dividends paid	(744)	(322)
Other	14	(78)
Net cash used in financing activities	(961)	(2,057)
Net decrease in cash and cash equivalents	(5,026)	(2,915)
Cash and cash equivalents, beginning of period	9,799	7,662

Cash and cash equivalents, end of period	$4,773	$4,747
Cash paid for:		
Interest	$221	$220
Income taxes	$776	$398

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF EQUITY
(in millions, except per-share amounts)
(Unaudited)

Three Months Ended October 27, 2012	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders' Equity	Non-controlling Interests	Total Equity
BALANCE AT JULY 28, 2012	5,298	$ 39,271	$ 11,354	$ 661	$ 51,286	$ 15	$ 51,301
Net income			2,092		2,092		2,092
Other comprehensive income				172	172		172
Issuance of common stock	39	117			117		117
Repurchase of stock - repurchase program	(15)	(114)	(139)		(253)		(253)
Shares repurchased for tax withholdings on vesting of restricted stock units	(11)	(203)			(203)		(203)
Cash dividends declared ($0.14 per common share)			(744)		(744)		(744)
Tax effects from employee stock incentive plans		(87)			(87)		(87)
Share-based compensation expense		306			306		306
BALANCE AT OCTOBER 27, 2012	5,311	$ 39,290	$ 12,563	$ 833	$ 52,686	$ 15	$ 52,701

Three Months Ended October 29, 2011	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders' Equity	Non-controlling Interests	Total Equity
BALANCE AT JULY 30, 2011	5,435	$ 38,648	$ 7,284	$ 1,294	$ 47,226	$ 33	$ 47,259
Net income			1,777		1,777		1,777
Other comprehensive loss				(313)	(313)	(7)	(320)
Issuance of common stock	45	203			203		203
Repurchase of common stock	(100)	(715)	(829)		(1,544)		(1,544)
Shares repurchased for tax withholdings on vesting of restricted stock units	(9)	(137)			(137)		(137)
Cash dividends declared ($0.06 per common share)			(322)		(322)		(322)
Tax effects from employee stock incentive plans		(43)			(43)		(43)
Share-based compensation expense		341			341		341
BALANCE AT OCTOBER 29, 2011	5,371	$ 38,297	$ 7,910	$ 981	$ 47,188	$ 26	$ 47,214

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of October 27, 2012, the Company's Board of Directors had authorized an aggregate repurchase of up to $82 billion of common stock under this program with no termination date. For additional information regarding stock repurchases, see Note 13 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impacts on Cisco shareholders' equity are summarized in the following table (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Total Cisco Shareholders' Equity
Repurchases of common stock under the repurchase program	3,755	$17,155	$59,231	$76,386

See Notes to Consolidated Financial Statements.

CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the "Company" or "Cisco") is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2013 and fiscal 2012 are each 52-week fiscal years. The Consolidated Financial Statements include the accounts of Cisco and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. The Company conducts business globally and is primarily managed on a geographic basis in the following three geographic segments: the Americas; Europe, Middle East, and Africa ("EMEA"); and Asia Pacific, Japan, and China ("APJC").

The accompanying financial data as of October 27, 2012 and for the three months ended October 27, 2012 and October 29, 2011 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. The July 28, 2012 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended July 28, 2012.

The Company consolidates its investment in a venture fund managed by SOFTBANK Corp. and its affiliates ("SOFTBANK") and Insieme Networks, Inc. ("Insieme") as these are variable interest entities and the Company is the primary beneficiary. The noncontrolling interests attributed to SOFTBANK are presented as a separate component from the Company's equity in the equity section of the Consolidated Balance Sheets. SOFTBANK's share of the earnings in the venture fund and the loss attributable to the noncontrolling interests in Insieme are not presented separately in the Consolidated Statements of Operations as these amounts are not material for any of the fiscal periods presented.

In the opinion of management, all adjustments (which include normal recurring adjustments, except as disclosed herein) necessary to present fairly the statement of financial position as of October 27, 2012 and the results of operations, cash flows, and equity for the three months ended October 27, 2012 and October 29, 2011, as applicable, have been made. The results of operations for the three months ended October 27, 2012 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Certain reclassifications have been made to prior period amounts in order to conform to the current period's presentation. The Company has evaluated subsequent events through the date that the financial statements were issued.

2. Summary of Significant Accounting Policies

(a) New Accounting Updates Recently Adopted

In June 2011, the FASB issued an accounting standard update to provide guidance on increasing the prominence of items reported in other comprehensive income, which eliminated the option to present components of other comprehensive income as part of the statement of equity. The Company adopted this accounting standard in the first quarter of fiscal 2013.

In August 2011, the FASB approved a revised accounting standard update intended to simplify how an entity tests goodwill for impairment. The amendment will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This accounting standard update became effective for the Company beginning in the first quarter of fiscal 2013, and its adoption did not have any impact on the Company's Consolidated Financial Statements.

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CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(b) Recent Accounting Standards or Updates Not Yet Effective

In December 2011, the FASB issued an accounting standard update requiring enhanced disclosures about certain financial instruments and derivative instruments that are offset in the statement of financial position or that are subject to enforceable master netting arrangements or similar agreements. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2014, at which time the Company will include the required disclosures.

In July 2012, the FASB issued an accounting standard update intended to simplify how an entity tests indefinite-lived intangible assets other than goodwill for impairment by providing entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2014, and early adoption is permitted. The adoption of this accounting standard update is not expected to have a material impact on the Company's Consolidated Financial Statements.

3. Business Combinations

(a) Acquisition Summary

On July 30, 2012, the Company completed its acquisition of NDS Group Limited (“NDS”), a leading provider of video software and content security solutions that enable service providers and media companies to securely deliver and monetize new video entertainment experiences. The acquisition of NDS is expected to complement and accelerate the delivery of Cisco Videoscape, the Company's comprehensive content delivery platform that enables service providers and media companies to deliver next-generation entertainment experiences. With the NDS acquisition, the Company aims to broaden its opportunities in the service provider market and to expand its reach into emerging markets such as China and India, where NDS has an established customer presence.

Under the terms of the acquisition agreement, the Company paid total cash consideration of approximately $5.0 billion, which included the repayment of $993 million of pre-existing NDS debt to third party creditors at the closing of the acquisition. The following table summarizes the purchase consideration for the NDS acquisition (in millions):

	Fair Value
Cash consideration to seller	$4,012
Repayment of NDS debt to third party creditors	993
Total purchase consideration	$5,005

The payment of the total purchase consideration of approximately $5.0 billion shown above, net of $98 million cash and cash equivalents acquired, is classified as a use of cash under investing activities in the Consolidated Statements of Cash Flows.

The Company's purchase price allocation for NDS is preliminary and subject to revision as additional information about fair value of assets and liabilities becomes available. Additional information, which existed as of the acquisition date but at that time was unknown to the Company, may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to goodwill retroactive to the period in which the acquisition occurred.

A summary of the preliminary allocation of the total purchase consideration for NDS is presented as follows (in millions):

	Fair Value
Cash and cash equivalents	$98
Accounts receivable, net	199
Other tangible assets	268
Goodwill	3,444
Purchased intangible assets	1,746

Deferred tax liabilities, net	(378)
Liabilities assumed	(372)
Total purchase consideration	$5,005

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CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The Company completed three additional business combinations during the three months ended October 27, 2012 for a total cash consideration of $5 million. A summary of the allocation of the total purchase consideration is presented as follows (in millions):

	Purchase Consideration	Net Liabilities Assumed	Purchased Intangible Assets	Goodwill
All other acquisitions	$5	$(3)	$7	$1

The total cash and cash equivalents acquired from these business combinations were immaterial.

(b) Other Acquisition Information

Total transaction costs related to the Company's business combination activities were $6 million and $2 million for the three months ended October 27, 2012 and October 29, 2011, respectively. These transaction costs were expensed as incurred as general and administrative ("G&A") expenses.

The goodwill generated from the Company's business combinations completed during the three months ended October 27, 2012 is primarily related to expected synergies. The goodwill is generally not deductible for U.S. federal income tax purposes.

The Consolidated Financial Statements include the operating results of each business combination from the date of acquisition. Pro forma results of operations for the acquisitions completed during the three months ended October 27, 2012 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company's financial results.

(c) Pending Acquisition of Meraki Inc.

On November 18, 2012, the Company announced that it had entered into a definitive agreement to acquire privately held Meraki Inc. ("Meraki"), a leader in cloud networking. Meraki offers mid-market customers on-premise networking solutions centrally managed from the cloud that are easy to deploy and manage. With its acquisition of Meraki, the Company intends to address the rapidly occurring shift to cloud networking as a key part of the Company's overall strategy to accelerate the adoption of software-based business models that provide new consumption options for customers and revenue opportunities for partners.

Under the terms of the agreement, the Company will pay approximately $1.2 billion in cash to acquire Meraki. The acquisition is expected to close in the second quarter of fiscal year 2013 and is subject to customary closing conditions, including regulatory review.

4. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the goodwill allocated to the Company's reportable segments as of and during the three months ended October 27, 2012 (in millions):

	Balance at July 28, 2012	Acquisition of NDS	All Other Acquisitions	Balance at October 27, 2012
Americas	$11,755	$1,230	$1	$12,986
EMEA	3,287	1,327	—	4,614
APJC	1,956	887	—	2,843
Total	$16,998	$3,444	$1	$20,443

CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

(b) Purchased Intangible Assets

The following table presents details of the Company's intangible assets acquired through business combinations completed during the three months ended October 27, 2012 (in millions, except years):

	FINITE LIVES						INDEFINITE LIVES	TOTAL
	TECHNOLOGY		CUSTOMER RELATIONSHIPS		OTHER		IPR&D	
	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount	Amount
NDS Group Limited	6.4	$807	6.7	$818	7.4	$27	$ 94	$1,746
All other acquisitions	3.0	7	—	—	—	—	—	7
Total		$814		$818		$27	$ 94	$1,753

The following tables present details of the Company's purchased intangible assets (in millions):

October 27, 2012	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	$3,053	$(1,027)	$2,026
Customer relationships	3,079	(1,780)	1,299
Other	73	(43)	30
Total purchased intangible assets with finite lives	6,205	(2,850)	3,355
In-process research and development, with indefinite lives	94	—	94
Total	$6,299	$(2,850)	$3,449

July 28, 2012	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	$2,267	$(908)	$1,359
Customer relationships	2,261	(1,669)	592
Other	49	(41)	8
Total	$4,577	$(2,618)	$1,959

Purchased intangible assets include intangible assets acquired through business combinations as well as through direct purchases or licenses.

The following table presents the amortization of purchased intangible assets (in millions):

	Three Months Ended	
	October 27, 2012	October 29, 2011
Amortization of purchased intangible assets:		
Cost of sales	$143	$96
Operating expenses	122	99
Total	$265	$195

There were no impairment charges related to purchased intangible assets during the three months ended October 27, 2012 and October 29, 2011.

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CISCO SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The estimated future amortization expense of purchased intangible assets with finite lives as of October 27, 2012 is as follows (in millions):

Fiscal Year	Amount
2013 (remaining nine months)	$702
2014	785
2015	701
2016	474
2017	325
Thereafter	368
Total	$3,355

5. Restructuring and Other Charges

In fiscal 2011, the Company initiated a number of key targeted actions to address several areas in its business model. These actions were intended to simplify and focus the Company's organization and operating model, align the Company's cost structure given transitions in the marketplace, divest or exit underperforming operations, and deliver value to the Company's shareholders. The Company initiated these actions to align its business based on its five foundational priorities: leadership in its core business (routing, switching, and associated services), which includes comprehensive security and mobility solutions; collaboration; data center virtualization and cloud; video; and architectures for business transformation.

Pursuant to the restructuring that the Company announced in July 2011, the Company has incurred cumulative charges of approximately $1.1 billion (included as part of the charges discussed below). The Company has substantially completed the July 2011 restructuring and does not expect significant remaining charges related to these actions.

The following table summarizes the activities related to the restructuring and other charges pursuant to the Company's July 2011 announcement related to the realignment and restructuring of the Company's business as well as certain consumer product lines as announced during April 2011 (in millions):

	Voluntary Early Retirement Program	Employee Severance	Goodwill and Intangible Assets	Other	Total
Gross charges in fiscal 2011	$453	$247	$71	$28	$799
Cash payments	(436)	(13)	—	—	(449)
Non-cash items	—	—	(71)		