

CISCO SYSTEMS, INC.
Form 10-Q
February 19, 2019
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 26, 2019

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 77-0059951

(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Number of shares of the registrant's common stock outstanding as of February 14, 2019: 4,402,027,716

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Cisco Systems, Inc.

Form 10-Q for the Quarter Ended January 26, 2019

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CISCO SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except par value)

(Unaudited)

	January 26, 2019	July 28, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$9,835	\$8,934
Investments	30,548	37,614
Accounts receivable, net of allowance for doubtful accounts of \$135 at January 26, 2019 and \$129 at July 28, 2018	3,745	5,554
Inventories	1,701	1,846
Financing receivables, net	5,057	4,949
Other current assets	2,231	2,940
Total current assets	53,117	61,837
Property and equipment, net	2,931	3,006
Financing receivables, net	4,565	4,882
Goodwill	33,293	31,706
Purchased intangible assets, net	2,270	2,552
Deferred tax assets	4,081	3,219
Other assets	2,205	1,582
TOTAL ASSETS	\$ 102,462	\$ 108,784
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	\$9,737	\$5,238
Accounts payable	1,655	1,904
Income taxes payable	1,110	1,004
Accrued compensation	2,599	2,986
Deferred revenue	9,976	11,490
Other current liabilities	4,402	4,413
Total current liabilities	29,479	27,035
Long-term debt	15,893	20,331
Income taxes payable	7,760	8,585
Deferred revenue	7,285	8,195
Other long-term liabilities	1,256	1,434
Total liabilities	61,673	65,580
Commitments and contingencies (Note 13)		
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; 4,424 and 4,614 shares issued and outstanding at January 26, 2019 and July 28, 2018, respectively	41,361	42,820
Retained earnings	538	1,233
Accumulated other comprehensive income (loss)	(1,110)	(849)
Total equity	40,789	43,204

TOTAL LIABILITIES AND EQUITY

\$ 102,462 \$ 108,784

See Notes to Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
REVENUE:				
Product	\$9,273	\$ 8,709	\$19,163	\$ 17,763
Service	3,173	3,178	6,355	6,260
Total revenue	12,446	11,887	25,518	24,023
COST OF SALES:				
Product	3,614	3,354	7,413	6,969
Service	1,059	1,035	2,186	2,129
Total cost of sales	4,673	4,389	9,599	9,098
GROSS MARGIN	7,773	7,498	15,919	14,925
OPERATING EXPENSES:				
Research and development	1,557	1,549	3,165	3,116
Sales and marketing	2,271	2,235	4,681	4,569
General and administrative	509	483	720	1,040
Amortization of purchased intangible assets	39	60	73	121
Restructuring and other charges	186	98	264	250
Total operating expenses	4,562	4,425	8,903	9,096
OPERATING INCOME	3,211	3,073	7,016	5,829
Interest income	328	396	672	775
Interest expense	(223)	(247)	(444)	(482)
Other income (loss), net	27	10	8	72
Interest and other income (loss), net	132	159	236	365
INCOME BEFORE PROVISION FOR INCOME TAXES	3,343	3,232	7,252	6,194
Provision for income taxes	521	12,010	881	12,578
NET INCOME (LOSS)	\$2,822	\$ (8,778)	\$6,371	\$ (6,384)
Net income (loss) per share:				
Basic	\$0.63	\$ (1.78)	\$1.41	\$ (1.29)
Diluted	\$0.63	\$ (1.78)	\$1.40	\$ (1.29)
Shares used in per-share calculation:				
Basic	4,470	4,924	4,517	4,942
Diluted	4,505	4,924	4,557	4,942
See Notes to Consolidated Financial Statements.				

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in millions)

(Unaudited)

	Three Months Ended		Six Months Ended	
	January 26,	January 27,	January 26,	January 27,
	2019	2018	2019	2018
Net income (loss)	\$2,822	\$ (8,778)	\$6,371	\$ (6,384)
Available-for-sale investments:				
Change in net unrealized gains and losses, net of tax benefit (expense) of \$(12) and \$1 for the second quarter and first six months of fiscal 2019, respectively, and \$1 and \$(22) for the corresponding periods of fiscal 2018, respectively	82	(191)	87	(196)
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$(1) for each of the second quarter and first six months of fiscal 2019, respectively, and \$15 and \$25 for the corresponding periods of fiscal 2018, respectively	4	(43)	10	(66)
	86	(234)	97	(262)
Cash flow hedging instruments:				
Change in unrealized gains and losses, net of tax benefit (expense) of \$1 and \$2 for the second quarter and first six months of fiscal 2019, respectively, and \$(2) and \$(3) for the corresponding periods of fiscal 2018, respectively	(4)	28	(7)	35
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$0 for each of the second quarter and first six months of fiscal 2019, respectively, and \$2 and \$4 for the corresponding periods of fiscal 2018, respectively	(1)	(16)	(1)	(27)
	(5)	12	(8)	8
Net change in cumulative translation adjustment and actuarial gains and losses net of tax benefit (expense) of \$0 and \$(1) for the second quarter and first six months of fiscal 2019, respectively, and \$(4) and \$(6) for the corresponding periods of fiscal 2018, respectively	27	274	(182)	291
Other comprehensive income (loss)	108	52	(93)	37
Comprehensive income (loss)	2,930	(8,726)	6,278	(6,347)
Comprehensive (income) loss attributable to noncontrolling interests	—	—	—	—
Comprehensive income (loss) attributable to Cisco Systems, Inc.	\$2,930	\$ (8,726)	\$6,278	\$ (6,347)

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Six Months Ended	
	January 26, 2019	January 27, 2018
Cash flows from operating activities:		
Net income (loss)	\$6,371	\$(6,384)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization, and other	952	1,112
Share-based compensation expense	792	785
Provision (benefit) for receivables	30	(43)
Deferred income taxes	(257)	1,021
(Gains) losses on divestitures, investments and other, net	(77)	(174)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	1,613	1,236
Inventories	(203)	(276)
Financing receivables	161	(156)
Other assets	(652)	(15)
Accounts payable	(296)	(338)
Income taxes, net	(830)	10,246
Accrued compensation	(339)	(189)
Deferred revenue	207	237
Other liabilities	88	88
Net cash provided by operating activities	7,560	7,150
Cash flows from investing activities:		
Purchases of investments	(677)	(13,954)
Proceeds from sales of investments	3,055	9,111
Proceeds from maturities of investments	6,263	7,365
Acquisitions and divestitures	(1,599)	(727)
Purchases of investments in privately held companies	(68)	(89)
Return of investments in privately held companies	43	124
Acquisition of property and equipment	(473)	(379)
Proceeds from sales of property and equipment	10	51
Other	(12)	(17)
Net cash provided by investing activities	6,542	1,485
Cash flows from financing activities:		
Issuances of common stock	312	302
Repurchases of common stock—repurchase program	(10,062)	(5,457)
Shares repurchased for tax withholdings on vesting of restricted stock units	(514)	(433)
Short-term borrowings, original maturities of 90 days or less, net	—	5,095
Issuances of debt	—	6,877
Repayments of debt	—	(6,230)
Dividends paid	(2,970)	(2,861)
Other	18	(22)
Net cash used in financing activities	(13,216)	(2,729)
Net increase in cash, cash equivalents, and restricted cash	886	5,906
Cash, cash equivalents, and restricted cash, beginning of period	8,993	11,773

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Cash, cash equivalents, and restricted cash, end of period	\$9,879	\$ 17,679
Supplemental cash flow information:		
Cash paid for interest	\$421	\$ 454
Cash paid for income taxes, net	\$1,968	\$ 1,311

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 January 26, 2019	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT OCTOBER 27, 2018	4,517	\$ 41,897	\$3,169	\$ (1,218)	\$ 43,848	\$	—\$43,848
Net income			2,822		2,822		2,822
Other comprehensive income (loss)				108	108		108
Issuance of common stock	22	304			304		304
Repurchase of common stock	(111)	(1,033)	(3,983)		(5,016)		(5,016)
Shares repurchased for tax withholdings on vesting of restricted stock units	(4)	(196)			(196)		(196)
Cash dividends declared (\$0.33 per common share)			(1,470)		(1,470)		(1,470)
Share-based compensation		389			389		389
BALANCE AT JANUARY 26, 2019	4,424	\$ 41,361	\$538	\$ (1,110)	\$ 40,789	\$	—\$40,789

Six Months Ended January 26, 2019	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT JULY 28, 2018	4,614	\$ 42,820	\$1,233	\$ (849)	\$ 43,204	\$	—\$43,204
Net income			6,371		6,371		6,371
Other comprehensive income (loss)				(93)	(93)		(93)
Issuance of common stock	41	312			312		312
Repurchase of common stock	(220)	(2,049)	(7,993)		(10,042)		(10,042)
Shares repurchased for tax withholdings on vesting of restricted stock units	(11)	(514)			(514)		(514)
Cash dividends declared (\$0.66 per common share)			(2,970)		(2,970)		(2,970)
Effect of adoption of accounting standards			3,897	(168)	3,729		3,729
Share-based compensation		792			792		792
BALANCE AT JANUARY 26, 2019	4,424	\$ 41,361	\$538	\$ (1,110)	\$ 40,789	\$	—\$40,789

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Three Months Ended January 27, 2018	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT OCTOBER 28, 2017	4,951	\$ 44,872	\$20,647	\$ 31	\$ 65,550	\$ —	—\$65,550
Net loss			(8,778)		(8,778)		(8,778)
Other comprehensive income (loss)				52	52	—	52
Issuance of common stock	22	293			293		293
Repurchase of common stock	(103)	(931)	(3,080)		(4,011)		(4,011)
Shares repurchased for tax withholdings on vesting of restricted stock units	(2)	(91)			(91)		(91)
Cash dividends declared (\$0.29 per common share)			(1,425)		(1,425)		(1,425)
Share-based compensation		393			393		393
Purchase acquisitions and other		(1)			(1)		(1)
BALANCE AT JANUARY 27, 2018	4,868	\$ 44,535	\$7,364	\$ 83	\$ 51,982	\$ —	—\$51,982
Six Months Ended January 27, 2018	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT JULY 29, 2017	4,983	\$ 45,253	\$20,838	\$ 46	\$ 66,137	\$ —	—\$66,137
Net loss			(6,384)		(6,384)		(6,384)
Other comprehensive income (loss)				37	37		37
Issuance of common stock	52	302			302		302
Repurchase of common stock	(154)	(1,393)	(4,238)		(5,631)		(5,631)
Shares repurchased for tax withholdings on vesting of restricted stock units	(13)	(433)			(433)		(433)
Cash dividends declared (\$0.58 per common share)			(2,861)		(2,861)		(2,861)
Effect of adoption of accounting standards			9		9		9
Share-based compensation		785			785		785
Purchase acquisitions and other		21			21		21
BALANCE AT JANUARY 27, 2018	4,868	\$ 44,535	\$7,364	\$ 83	\$ 51,982	\$ —	—\$51,982

See Notes to Consolidated Financial Statements.

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

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the “Company,” “Cisco,” “we,” “us,” or “our”) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2019 and fiscal 2018 are each 52-week fiscal years. The Consolidated Financial Statements include our accounts and those of our subsidiaries. All intercompany accounts and transactions have been eliminated. We conduct business globally and are 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). We have prepared the accompanying financial data as of January 26, 2019 and for the second quarter and first six months of fiscal 2019 and fiscal 2018, without audit, pursuant to the rules and regulations of the U.S. 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, 2018 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, we believe 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 our Annual Report on Form 10-K for the fiscal year ended July 28, 2018.

We consolidate our investments in certain variable interest entities (VIEs) where we are the primary beneficiary. The noncontrolling interests attributed to these investments, if any, are presented as a separate component from our equity in the equity section of the Consolidated Balance Sheets. The share of earnings attributable to the noncontrolling interests 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 normal recurring adjustments necessary to present fairly the consolidated balance sheet as of January 26, 2019; the results of operations and the statements of comprehensive income (loss) for the second quarter and first six months of fiscal 2019 and fiscal 2018; the statements of cash flows for the first six months of fiscal 2019 and fiscal 2018; and the statements of equity for the second quarter and first six months of fiscal 2019 and fiscal 2018, as applicable, have been made. The results of operations for the second quarter and first six months of fiscal 2019 and fiscal 2018 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Certain reclassifications have been made to the amounts in prior periods in order to conform to the current period’s presentation. We have evaluated subsequent events through the date that the financial statements were issued.

2. Recent Accounting Pronouncements

(a) New Accounting Updates Recently Adopted

Revenue Recognition In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Codification (“ASC”) 606, Revenue from Contracts with Customers, a new accounting standard related to revenue recognition. ASC 606 supersedes nearly all U.S. GAAP on revenue recognition and eliminated industry-specific guidance. The underlying principle of ASC 606 is to recognize revenue when a customer obtains control of promised goods or services at an amount that reflects the consideration that is expected to be received in exchange for those goods or services. It also requires increased disclosures including the nature, amount, timing, and uncertainty of revenues and cash flows related to contracts with customers.

ASC 606 allows two methods of adoption: i) retrospectively to each prior period presented (“full retrospective method”), or ii) retrospectively with the cumulative effect recognized in retained earnings as of the date of adoption (“modified retrospective method”). At the beginning of the first quarter of fiscal 2019, we adopted ASC 606 using the modified retrospective method to those contracts that were not completed as of July 28, 2018. Refer to Opening Balance Adjustments below for the impact of adoption on our Consolidated Financial Statements.

We have implemented new accounting policies, systems, processes, and internal controls necessary to support the requirements of ASC 606.

ASC 606 primarily impacts our revenue recognition for software arrangements and sales to two-tier distributors. In both areas, the new standard accelerates the recognition of revenue.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The table below details the timing of when revenue was typically recognized under the prior revenue standard compared to the timing of when revenue is typically recognized under ASC 606 for these major areas:

	Prior Revenue Standard	ASC 606
Software arrangements:		
Perpetual software licenses	Upfront	Upfront
Term software licenses	Ratable	Upfront
Security software licenses	Ratable	Ratable
Enterprise license agreements (software licenses)	Ratable	Upfront
Software support (maintenance)	Ratable	Ratable
Software-as-a-service	Ratable	Ratable
Two-tier distribution	Sell-Through	Sell-In

In addition to the above revenue recognition timing impacts, ASC 606 requires incremental contract acquisition costs (such as sales commissions) for customer contracts to be capitalized and amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the assets relates.

We enter into contracts with customers that can include various combinations of products and services which are generally distinct and accounted for as separate performance obligations. As a result, our contracts may contain multiple performance obligations. We determine whether arrangements are distinct based on whether the customer can benefit from the product or service on its own or together with other resources that are readily available and whether our commitment to transfer the product or service to the customer is separately identifiable from other obligations in the contract. We classify our hardware, perpetual software licenses, and software-as-a-service (SaaS) as distinct performance obligations. Term software licenses represent multiple obligations, which include software licenses and software maintenance. In transactions where we deliver hardware or software, we are typically the principal and we record revenue and costs of goods sold on a gross basis. We refer to our term software licenses, security software licenses, SaaS, and associated service arrangements as subscription offers.

We recognize revenue upon transfer of control of promised goods or services in a contract with a customer in an amount that reflects the consideration we expect to receive in exchange for those products or services. Transfer of control occurs once the customer has the contractual right to use the product, generally upon shipment or once delivery and risk of loss has transferred to the customer. Transfer of control can also occur over time for software maintenance and services as the customer receives the benefit over the contract term. Our hardware and perpetual software licenses are distinct performance obligations where revenue is recognized upfront upon transfer of control. Term software licenses include multiple performance obligations where the term licenses are recognized upfront upon transfer of control, with the associated software maintenance revenue recognized ratably over the contract term as services and software updates are provided. SaaS arrangements have one distinct performance obligation which is satisfied over time with revenue recognized ratably over the contract term as the customer consumes the services. On our product sales, we record consideration from shipping and handling on a gross basis within net product sales. We record our revenue net of any associated sales taxes.

Significant Judgments

Revenue is allocated among these performance obligations in a manner that reflects the consideration that we expect to be entitled to for the promised goods or services based on standalone selling prices (SSP). SSP is estimated for each distinct performance obligation and judgment may be required in their determination. The best evidence of SSP is the observable price of a product or service when we sell the goods separately in similar circumstances and to similar customers. In instances where SSP is not directly observable, we determine SSP using information that may include market conditions and other observable inputs.

We apply judgment in determining the transaction price as we may be required to estimate variable consideration when determining the amount of revenue to recognize. Variable consideration includes various rebate, cooperative marketing, and other incentive programs that we offer to our distributors, partners and customers. When determining the amount of revenue to recognize, we estimate the expected usage of these programs, applying the expected value or most likely estimate and update the estimate at each reporting period as actual utilization becomes available. We also consider the customers' right of return in determining the transaction price, where applicable.

We assess certain software licenses, such as for security software, that contain critical updates or upgrades which customers can download throughout the contract term. Without these updates or upgrades, the functionality of the software would diminish over a relatively short time period. These updates or upgrades provide the customer the full functionality of the purchased security software licenses and are required to maintain the security license's utility as the risks and threats in the environment are rapidly

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

changing. In these circumstances, the revenue from these software arrangements is recognized as a distinct performance obligation satisfied over the contract term.

For the additional disclosures required as part of ASC 606 see Note 3.

Financial Instruments In January 2016, the FASB issued an accounting standard update that changes the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. The most significant impact of this accounting standard update is that it requires the remeasurement of investments not accounted for under the equity method to be recorded at fair value through the Consolidated Statement of Operations at the end of each reporting period. The application of this accounting standard update increases the variability of other income (loss), net.

Our equity investments are accounted for as follows:

- **Marketable equity securities** have readily determinable fair value (RDFV) that are measured and recorded at fair value.

- **Non-marketable equity securities** do not have RDFV and are measured using a measurement alternative recorded at cost less any impairment, plus or minus changes resulting from qualifying observable price changes. For certain of these securities, we have elected to apply the net asset value (NAV) practical expedient. The NAV is the estimated fair value of these investments.

Equity method investments are securities we do not control, but are able to exert significant influence over the investee. These investments are measured at cost less any impairment, plus or minus our share of equity method investee income or loss.

We adopted this accounting standard update beginning the first quarter of fiscal 2019. The standard was adopted using the modified retrospective method for our marketable equity securities and non-marketable equity securities measured using the NAV practical expedient. For our non-marketable equity securities measured using the measurement alternative, we applied the prospective method. Refer to Opening Balance Adjustments below for the impact of adoption on our Consolidated Balance Sheet.

Income Taxes on Intra-Entity Transfers of Assets In October 2016, the FASB issued an accounting standard update that requires recognition of the income tax consequences of intra-entity transfers of assets (other than inventory) at the transaction date. We adopted this accounting standard update beginning in the first quarter of fiscal 2019 on a modified retrospective basis. The ongoing impact of this standard will be facts and circumstances dependent on any transactions within its scope. Refer to Opening Balance Adjustments below for the impact of adoption on our Consolidated Balance Sheet.

Classification of Cash Flow Elements In August 2016, the FASB issued an accounting standard update related to the classification of certain cash receipts and cash payments on the statement of cash flows. We adopted this accounting standard update beginning in the first quarter of fiscal 2019 on a retrospective basis. The application of this accounting standard update did not have an impact on our Consolidated Statements of Cash Flows.

Restricted Cash in Statement of Cash Flows In November 2016, the FASB issued an accounting standard update that provides guidance on the classification and presentation of changes in restricted cash and cash equivalents in the statement of cash flows. We adopted this accounting standard update beginning in the first quarter of fiscal 2019 using a retrospective transition method to each period presented. The application of this accounting standard update did not have a material impact on our Consolidated Statements of Cash Flows. Prior period information has been retrospectively adjusted due to the adoption of ASU 2016-18, Statement of Cash Flows, Restricted Cash at the beginning of the first quarter of fiscal 2019.

Simplifying the Test for Goodwill Impairment In January 2017, the FASB issued an accounting standard update that removes Step

2 of the goodwill impairment test, which requires the assessment of fair value of individual assets and liabilities of a reporting unit to measure goodwill impairments. Goodwill impairment will now be the amount by which a reporting

unit's carrying value exceeds its fair value. We early adopted this accounting standard update beginning in the first quarter of fiscal 2019 on a prospective basis. The application of this accounting standard update did not have any impact on our Consolidated Financial Statements.

Definition of a Business In January 2017, the FASB issued an accounting standard update that clarifies the definition of a business to help companies evaluate whether acquisition or disposal transactions should be accounted for as asset groups or as businesses. We adopted this accounting standard update beginning in the first quarter of fiscal 2019 on a prospective basis. The impact of this accounting standard update will be fact dependent, but we expect that some transactions that were previously accounted for as business combinations or disposal transactions will be accounted for as asset purchases or asset sales under the accounting standard update.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Opening Balance Adjustments

The following table summarizes the cumulative effect of the changes made to the Consolidated Balance Sheet for the adoption of ASC 606, ASU 2016-01, Financial Instruments, and ASU 2016-16, Intra-Entity Transfers of Assets Other than Inventory (in millions):

Line Item in Consolidated Balance Sheet:	Balance at July 28, 2018	New Revenue Recognition Standard	New Financial Instruments Standard	New Intra-Entity Transfers Standard	Adjusted Balance at July 29, 2018
ASSETS					
Accounts receivable, net	\$5,554	\$ (104) ⁽¹⁾	\$ —	\$ —	\$5,450
Inventories	\$1,846	\$ (302) ⁽²⁾	\$ —	\$ —	\$1,544
Other current assets (includes capitalized contract acquisition costs)	\$2,940	\$ 371 ^{(3),(4)}	\$ —	\$ (25) ⁽³⁾	\$3,286
Deferred tax assets	\$3,219	\$ (624) ⁽³⁾	\$ (15) ⁽³⁾	\$ 1,415 ⁽⁸⁾	\$3,995
Other assets (includes capitalized contract acquisition costs)	\$1,582	\$ 327 ⁽⁴⁾	\$ 136 ⁽⁷⁾	\$ (91) ⁽³⁾	\$1,954
TOTAL ASSETS	\$108,784	\$ (332)	\$ 121	\$ 1,299	\$109,872
LIABILITIES AND EQUITY					
Income taxes payable	\$1,004	\$ —	\$ —	\$ 11 ⁽³⁾	\$1,015
Deferred revenue — current	\$11,490	\$ (1,702) ⁽⁵⁾	\$ —	\$ —	\$9,788
Other current liabilities	\$4,413	\$ 33 ⁽⁶⁾	\$ —	\$ —	\$4,446
Deferred revenue — non-current	\$8,195	\$ (1,081) ⁽⁵⁾	\$ —	\$ —	\$7,114
Other long-term liabilities	\$1,434	\$ 85 ⁽³⁾	\$ 13 ⁽³⁾	\$ —	\$1,532
Retained earnings	\$1,233	\$ 2,333 ⁽¹⁰⁾	\$ 283 ⁽¹⁰⁾	\$ 1,281 ⁽¹⁰⁾	\$5,130
Accumulated other comprehensive income (loss)	\$ (849)	\$ —	\$ (175) ⁽⁹⁾	\$ 7 ⁽³⁾	\$ (1,017)
TOTAL LIABILITIES AND EQUITY	\$108,784	\$ (332)	\$ 121	\$ 1,299	\$109,872

⁽¹⁾ Primarily represents the decrease to accounts receivable related to the change in recognizing revenue on sales to two-tier distributors from a sell-through to a sell-in basis

⁽²⁾ Primarily represents the reduction of inventory for the change from recognizing revenue on sales to two-tier distributors from a sell-through to a sell-in basis

⁽³⁾ Includes the impacts to deferred tax assets, liabilities and other income tax balances

⁽⁴⁾ Primarily represents capitalized contract acquisition costs (e.g. commissions)

⁽⁵⁾ Primarily represents deferred revenue adjusted to retained earnings primarily due to the change in revenue recognition for certain software arrangements from ratable to upfront, recognizing revenue on sales to two-tier distributors from a sell-through to a sell-in basis. Of this total \$2.8 billion adjustment, \$2.6 billion related to product deferred revenue, of which \$1.3 billion relates to our recurring software and subscription offers, \$0.6 billion relates to two-tier distribution, and the remainder relates to non-recurring software and other adjustments.

⁽⁶⁾ Primarily represents the reclassification of accounts receivable contra balances to other current liabilities, adjustments to rebate liabilities for the change from recognizing revenue on sales to two-tier distributors from a sell-through to a sell-in basis, and reclassifications from other current liabilities for amounts that are not contract liabilities under ASC 606

- (7) Represents the adjustment due to the remeasurement of non-marketable equity investments at fair value
- (8) Primarily represents the change in net deferred tax assets related to unrecognized income tax effects of intra-entity asset transfers
- (9) Represents the reclassification of net unrealized gains from accumulated other comprehensive income (loss) to retained earnings
- (10) Retained earnings impact from the adjustments noted above

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Impact of ASC 606 Adoption

The application of ASC 606 increased our total revenue by \$267 million and \$516 million in the second quarter and first six months of fiscal 2019, respectively. The application of ASC 606 did not have a material impact to either our cost of sales or our operating expenses in the second quarter and first six months of fiscal 2019. We recognized a \$152 million benefit to our provision for income taxes relating to indirect effects from the adoption of ASC 606 in the first quarter of fiscal 2019. For additional information regarding ASC 606, see Note 3 to the Consolidated Financial Statements.

In connection with the adoption of ASC 606, we recorded a transition adjustment to increase retained earnings by \$2.3 billion. See above for the transition impact of ASC 606 by balance sheet line item. As of January 26, 2019, the balance sheet changes attributable to ASC 606 related to accounts receivable, inventories, and deferred revenue were not materially different than the impacts upon adoption. In connection with the adoption of ASC 606, we established contract assets for unbilled receivables. As of January 26, 2019, we had total contract assets of \$557 million, of which \$241 million was recorded in other current assets and \$316 million was recorded in other assets. As of January 26, 2019, we had total capitalized contract acquisition costs of \$686 million, of which \$380 million was recorded in other current assets and \$306 million was recorded in other assets. The adoption of ASC 606 did not have any impact on net cash provided by operating activities.

(b) Recent Accounting Standards or Updates Not Yet Effective

Leases In February 2016, the FASB issued an accounting standard update and subsequent amendments related to leases requiring lessees to recognize operating and financing lease liabilities on the balance sheet, as well as corresponding right-of-use assets. The new lease standard also makes some changes to lessor accounting and aligns key aspects of the lessor accounting model with the revenue recognition standard. In addition, disclosures will be required to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. The accounting standard update will be effective for us beginning in the first quarter of fiscal 2020 and early adoption is permitted. We expect to adopt this accounting standard update on a modified retrospective basis in the first quarter of fiscal 2020, and we are currently evaluating the impact of this accounting standard update on our Consolidated Financial Statements.

Credit Losses of Financial Instruments In June 2016, the FASB issued an accounting standard update that requires measurement and recognition of expected credit losses for financial assets held based on historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amount. The accounting standard update will be effective for us beginning in the first quarter of fiscal 2021 and early adoption in fiscal 2020 is permitted. We expect to adopt this accounting standard update on a modified retrospective basis in the first quarter of fiscal 2021, and we are currently evaluating the impact of this accounting standard update on our Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Revenue

(a) Disaggregation of Revenue

We disaggregate our revenue into groups of similar products and services that depict the nature, amount, and timing of revenue and cash flows for our various offerings. The sales cycle, contractual obligations, customer requirements, and go-to-market strategies differ for each of our product categories, resulting in different economic risk profiles for each category. The following table presents this disaggregation of revenue (in millions):

	Three Months Ended		Six Months Ended	
	January 2019	January 2018	January 2019	January 2018
Revenue:				
Infrastructure Platforms	\$7,128	\$ 6,710	\$14,770	\$ 13,690
Applications	1,465	1,184	2,884	2,387
Security	658	557	1,308	1,142
Other Products	22	258	200	544
Total Product	9,273	8,709	19,163	17,763
Services	3,173	3,178	6,355	6,260
Total ⁽¹⁾	\$12,446	\$ 11,887	\$25,518	\$ 24,023

Amounts may not sum due to rounding.

⁽¹⁾ During the second quarter of fiscal 2019, we completed the divestiture of the Service Provider Video Software Solutions ("SPVSS") business. Total revenue includes SPVSS business revenue of \$0 and \$230 million for the second quarter of fiscal 2019 and 2018, respectively, and \$168 million and \$478 million for the first six months of fiscal 2019 and 2018, respectively.

Infrastructure Platforms consist of our core networking technologies of switching, routing, data center products, and wireless that are designed to work together to deliver networking capabilities and transport and/or store data. These technologies consist of both hardware and software offerings, including software licenses and software-as-a-service (SaaS), that help our customers build networks, automate, orchestrate, integrate, and digitize data. We are shifting and expanding more of our business to software and subscriptions across our core networking portfolio. Our hardware and perpetual software in this category are distinct performance obligations where revenue is recognized upfront upon transfer of control. Term software licenses are multiple performance obligations where the term license is recognized upfront upon transfer of control with the associated software maintenance revenue recognized ratably over the contract term. SaaS arrangements in this category have one distinct performance obligation which is satisfied over time with revenue recognized ratably over the contract term.

Applications consists of offerings that utilize the core networking and data center platforms to provide their functions. The products consist primarily of software offerings, including software licenses and SaaS, as well as hardware. Our perpetual software and hardware in this category are distinct performance obligations where revenue is recognized upfront upon transfer of control. Term software licenses are multiple performance obligations where the term license is recognized upfront upon transfer of control with the associated software maintenance revenue recognized ratably over the contract term. SaaS arrangements in this category have one distinct performance obligation which is satisfied over time with revenue recognized ratably over the contract term.

Security primarily includes our unified threat management, advanced threat security, and web security products. These products consist of both hardware and software offerings, including software licenses and SaaS. Updates and upgrades for the term software licenses are critical for our software to perform its intended commercial purpose because of the continuous need for our software to secure our customers' network environments against frequent threats. Therefore, security software licenses are generally represented by a single distinct performance obligation with revenue recognized ratably over the contract term. Our hardware and perpetual software in this category are distinct

performance obligations where revenue is recognized upfront upon transfer of control. SaaS arrangements in this category have one distinct performance obligation which is satisfied over time with revenue recognized ratably over the contract term.

Other Products primarily include our Service Provider Video Software Solutions and cloud and system management products. On May 1, 2018, we announced a definitive agreement to sell the SPVSS business. The sale closed on October 28, 2018. These products include both hardware and software licenses. Our offerings in this category are distinct performance obligations where revenue is recognized upfront upon transfer of control.

In addition to our product offerings, we provide a broad range of service and support options for our customers, including technical support services and advanced services. Technical support services represent the majority of these offerings which are distinct

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

performance obligations that are satisfied over time with revenue recognized ratably over the contract term. Advanced services are distinct performance obligations that are satisfied over time with revenue recognized as services are delivered.

The sales arrangements as discussed above are typically made pursuant to customer purchase orders based on master purchase or partner agreements. Cash is received based on our standard payment terms which is typically 30 days. We provide financing arrangements to customers for all of our hardware, software and service offerings. Refer to Note 8 for additional information. For these arrangements, cash is typically received over time.

(b) Contract Balances

Accounts receivable, net was \$3.7 billion as of January 26, 2019 compared to \$5.6 billion as of July 28, 2018, as reported on the Consolidated Balance Sheet.

Contract assets consist of unbilled receivables and are recorded when revenue is recognized in advance of scheduled billings to our customers. These amounts are primarily related to software and service arrangements where transfer of control has occurred but we have not yet invoiced. As of January 26, 2019 and July 29, 2018, our contract assets for these unbilled receivables were \$557 million and \$122 million, respectively, and were included in other current assets and other assets.

Contract liabilities consist of deferred revenue. Deferred revenue was \$17.3 billion as of January 26, 2019 compared to \$19.7 billion as of July 28, 2018. In connection with the adoption of ASC 606, we recorded an adjustment to retained earnings to reduce deferred revenue by \$2.8 billion. We recognized approximately \$2.6 billion and \$6.0 billion of revenue during the second quarter and first six months of fiscal 2019, respectively, that was included in the deferred revenue balance at July 29, 2018.

(c) Remaining Performance Obligations

Remaining Performance Obligations (RPO) are comprised of deferred revenue plus unbilled contract revenue. As of January 26, 2019, the aggregate amount of RPO was \$22.5 billion, comprised of \$17.3 billion of deferred revenue and \$5.2 billion of unbilled contract revenue. We expect approximately 56% of this amount to be recognized as revenue over the next year. Unbilled contract revenue represents non-cancelable contracts for which we have not invoiced, have an obligation to perform, and revenue has not yet been recognized in the financial statements.

(d) Capitalized Contract Acquisition Costs

In connection with the adoption of ASC 606, we began to capitalize direct and incremental costs incurred to acquire contracts, primarily sales commissions, for which the associated revenue is expected to be recognized in future periods. We incur these costs in connection with both initial contracts and renewals. These costs are initially deferred and typically amortized over the term of the customer contract which corresponds to the period of benefit. Deferred sales commissions were \$686 million and \$644 million as of January 26, 2019 and July 29, 2018, respectively, and were included in other current assets and other assets. The amortization expense associated with these costs was \$100 million and \$212 million for the second quarter and first six months of fiscal 2019, respectively, and was included in sales and marketing expenses.

4. Acquisitions and Divestitures

We completed three acquisitions during the first six months of fiscal 2019. A summary of the allocation of the total purchase consideration is presented as follows (in millions):

Purchase Consideration	Net Tangible Assets Acquired (Liabilities)	Purchased Goodwill Intangible Assets
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		Assumed)		
Duo	\$ 2,025	\$ (57)	\$ 342	\$ 1,740
Others (two in total) 60		3	8	49
Total	\$ 2,085	\$ (54)	\$ 350	\$ 1,789

On September 28, 2018, we completed our acquisition of privately held Duo Security, Inc. ("Duo"), a leading provider of unified access security and multi-factor authentication delivered through the cloud. Revenue from the Duo acquisition has been included in our Security product category.

The total purchase consideration related to acquisitions completed during the first six months of fiscal 2019 consisted of cash consideration. The total cash and cash equivalents acquired from these acquisitions was approximately \$85 million. Total transaction costs related to acquisition and divestiture activities were \$11 million and \$14 million for the first six months of fiscal 2019 and

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

fiscal 2018, respectively. These transaction costs were expensed as incurred in general and administrative expenses ("G&A") in the Consolidated Statements of Operations.

The goodwill generated from acquisitions completed during the first six months of fiscal 2019 is primarily related to expected synergies. The goodwill is generally not deductible for income tax purposes.

The Consolidated Financial Statements include the operating results of each acquisition from the date of acquisition. Pro forma results of operations and the revenue and net income subsequent to the acquisition date for the acquisitions completed during the first six months of fiscal 2019 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to our financial results.

Divestiture of Service Provider Video Software Solutions On October 28, 2018, we completed the sale of the Service Provider Video Software Solutions business. This business had tangible assets of approximately \$160 million (primarily comprised of accounts receivables, inventories and various other current and long-term assets) and net intangible assets and goodwill (based on relative fair value) of \$340 million. In addition, the business had total liabilities of approximately \$200 million (primarily comprised of deferred revenue and various other current and long-term liabilities). We recognized an immaterial gain from this transaction in the second quarter of fiscal 2019. We completed two divestitures during the second quarter of fiscal 2018. The financial statement impact of these divestitures was not material for the second quarter and first six months of fiscal 2018.

Acquisition of Luxtera On February 6, 2019, we completed our acquisition of Luxtera, Inc. ("Luxtera"), a semiconductor company, for total consideration of approximately \$660 million in cash and assumed equity awards. Revenue from the Luxtera acquisition will be included in our Infrastructure Platforms product category. We expect that most of the purchase price will be allocated to goodwill and purchased intangible assets.

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CISCO SYSTEMS, INC.

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5. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the goodwill allocated to our reportable segments as of January 26, 2019 and during the first six months of fiscal 2019 (in millions):

	Balance at July 28, 2018	Acquisitions & Divestitures	Other	Balance at January 26, 2019
Americas	\$19,998	\$ 1,082	\$(79)	\$ 21,001
EMEA	7,529	429	(22)	7,936
APJC	4,179	190	(13)	4,356
Total	\$31,706	\$ 1,701	\$(114)	\$ 33,293

“Other” in the table above primarily consists of foreign currency translation as well as immaterial purchase accounting adjustments.

(b) Purchased Intangible Assets

The following table presents details of our intangible assets acquired through acquisitions completed during the first six months of fiscal 2019 (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
Duo	5.0	\$ 153	5.0	\$ 94	2.5	\$ 18	\$ 77	\$ 342
Others (two in total)	5.0	8	—	—	—	—	—	8
Total		\$ 161		\$ 94		\$ 18	\$ 77	\$ 350

The following tables present details of our purchased intangible assets (in millions):

January 26, 2019	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,165	\$ (1,620)	\$ 1,545
Customer relationships	812	(292)	520
Other	55	(30)	25
Total purchased intangible assets with finite lives	4,032	(1,942)	2,090
In-process research and development, with indefinite lives	180	—	180
Total	\$4,212	\$ (1,942)	\$ 2,270

July 28, 2018	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,711	\$ (1,888)	\$ 1,823
Customer relationships	1,538	(937)	601

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Other	63	(38) 25
Total purchased intangible assets with finite lives	5,312	(2,863) 2,449
In-process research and development, with indefinite lives	103	—	103
Total	\$5,415	\$ (2,863) \$2,552

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

There were no impairment charges related to purchased intangible assets for the second quarter and first six months of fiscal 2019 and for the corresponding periods of fiscal 2018. Impairment charges are primarily a result of declines in estimated fair values of certain purchased intangible assets resulting from the reduction or elimination of expected future cash flows associated with certain of our technology and in-process research and development (IPR&D) intangible assets.

The following table presents the amortization of purchased intangible assets, including impairment charges (in millions):

	Three Months Ended January 26, 2019		Six Months Ended January 26, 2019	
	2019	2018	2019	2018
Amortization of purchased intangible assets:				
Cost of sales	\$ 156	\$ 160	\$ 307	\$ 314
Operating expenses	39	60	73	121
Total	\$ 195	\$ 220	\$ 380	\$ 435

The estimated future amortization expense of purchased intangible assets with finite lives as of January 26, 2019 is as follows (in millions):

Fiscal Year	Amount
2019 (remaining six months)	\$ 382
2020	\$ 726
2021	\$ 530
2022	\$ 274
2023	\$ 133
Thereafter	\$ 45

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Restructuring and Other Charges

We initiated a restructuring plan during fiscal 2018 (the "Fiscal 2018 Plan") in order to realign the organization and enable further investment in key priority areas with estimated pretax charges of approximately \$600 million. These aggregate pretax charges are primarily cash-based and consist of employee severance and other one-time termination benefits, and other associated costs. In connection with the Fiscal 2018 Plan, we have incurred charges of \$186 million and \$264 million for the second quarter and first six months of fiscal 2019, respectively, and have incurred cumulative charges of \$372 million. We expect the Fiscal 2018 Plan to be substantially completed in fiscal 2019.

We announced a restructuring plan in August 2016 (the "Fiscal 2017 Plan"), in order to reinvest in our key priority areas. In connection with the Fiscal 2017 Plan, we incurred cumulative charges of approximately \$1.0 billion, which were primarily cash-based and consisted of employee severance and other one-time termination benefits, and other associated costs. We completed the Fiscal 2017 Plan in fiscal 2018.

The following tables summarize the activities related to the restructuring and other charges (in millions):

	FISCAL 2017 AND PRIOR PLANS		FISCAL 2018 PLAN		
	Employee Severance	Other	Employee Severance	Other	Total
Liability as of July 28, 2018	\$41	\$13	\$19	\$—	\$73
Charges	—	(1)	222	43	264
Cash payments	(31)	(3)	(202)	(1)	(237)
Non-cash items	—	—	—	(42)	(42)
Liability as of January 26, 2019	\$10	\$9	\$39	\$—	\$58

	FISCAL 2017 AND PRIOR PLANS		
	Employee Severance	Other	Total
Liability as of July 29, 2017	\$74	\$43	\$117
Charges	223	27	250
Cash payments	(213)	(27)	(240)
Non-cash items	3	(18)	(15)
Liability as of January 27, 2018	\$87	\$25	\$112

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Balance Sheet Details

The following tables provide details of selected balance sheet items (in millions):

	January 26, July 28,	
	2019	2018
Cash and cash equivalents	\$ 9,835	\$ 8,934
Restricted cash included in other current assets	23	32
Restricted cash included in other assets	21	27
Total cash, cash equivalents, and restricted cash	\$ 9,879	\$ 8,993
Inventories:		
Raw materials	\$468	\$423
Finished goods:		
Deferred cost of sales and distributor inventory	74	443
Manufactured finished goods	908	689
Total finished goods	982	1,132
Service-related spares	228	258
Demonstration systems	23	33
Total	\$1,701	\$1,846
Property and equipment, net:		
Gross property and equipment:		
Land, buildings, and building and leasehold improvements	\$4,731	\$4,710
Computer equipment and related software	965	1,085
Production, engineering, and other equipment	5,616	5,734
Operating lease assets	529	356
Furniture and fixtures	369	358
Total gross property and equipment	12,210	12,243
Less: accumulated depreciation and amortization	(9,279)	(9,237)
Total	\$2,931	\$3,006
Deferred revenue:		
Service	\$11,246	\$11,431
Product	6,015	8,254
Total	\$17,261	\$19,685
Reported as:		
Current	\$9,976	\$11,490
Noncurrent	7,285	8,195
Total	\$17,261	\$19,685

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CISCO SYSTEMS, INC.

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(Unaudited)

8. Financing Receivables and Operating Leases

(a) Financing Receivables

Financing receivables primarily consist of lease receivables, loan receivables, and financed service contracts. Lease receivables represent sales-type and direct-financing leases resulting from the sale of Cisco's and complementary third-party products and are typically collateralized by a security interest in the underlying assets. Lease receivables consist of arrangements with terms of four years on average. Loan receivables represent financing arrangements related to the sale of our hardware, software, and services, which may include additional funding for other costs associated with network installation and integration of our products and services. Loan receivables generally have terms of up to three years. Financed service contracts include financing receivables related to technical support and advanced services. Revenue related to the technical support services is typically deferred and included in deferred service revenue and is recognized ratably over the period during which the related services are to be performed, which typically ranges from one to three years.

A summary of our financing receivables is presented as follows (in millions):

	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
January 26, 2019				
Gross	\$ 2,483	\$ 4,926	\$ 2,398	\$9,807
Residual value	153	—	—	153
Unearned income	(138)	—	—	(138)
Allowance for credit loss	(127)	(64)	(9)	(200)
Total, net	\$ 2,371	\$ 4,862	\$ 2,389	\$9,622
Reported as:				
Current	\$ 1,121	\$ 2,502	\$ 1,434	\$5,057
Noncurrent	1,250	2,360	955	4,565
Total, net	\$ 2,371	\$ 4,862	\$ 2,389	\$9,622
July 28, 2018				
Gross	\$ 2,688	\$ 4,999	\$ 2,326	\$10,013
Residual value	164	—	—	164
Unearned income	(141)	—	—	(141)
Allowance for credit loss	(135)	(60)	(10)	(205)
Total, net	\$ 2,576	\$ 4,939	\$ 2,316	\$9,831
Reported as:				
Current	\$ 1,249	\$ 2,376	\$ 1,324	\$4,949
Noncurrent	1,327	2,563	992	4,882
Total, net	\$ 2,576	\$ 4,939	\$ 2,316	\$9,831

Future minimum lease payments to Cisco on lease receivables as of January 26, 2019 are summarized as follows (in millions):

Fiscal Year	Amount
2019 (remaining six months)	\$ 637
2020	855
2021	532
2022	309
2023	126

Thereafter	24
Total	\$ 2,483

Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or defaults.

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CISCO SYSTEMS, INC.

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(b) Credit Quality of Financing Receivables

Gross receivables, excluding residual value, less unearned income categorized by our internal credit risk rating as of January 26, 2019 and July 28, 2018 are summarized as follows (in millions):

INTERNAL CREDIT RISK
RATING

January 26, 2019	1 to 4	5 to 6	7 and Higher	Total
Lease receivables	\$1,233	\$1,066	\$ 46	\$2,345
Loan receivables	3,000	1,875	51	4,926
Financed service contracts	1,390	995	13	2,398
Total	\$5,623	\$3,936	\$ 110	\$9,669

INTERNAL CREDIT RISK
RATING

July 28, 2018	1 to 4	5 to 6	7 and Higher	Total
Lease receivables	\$1,294	\$1,199	\$ 54	\$2,547
Loan receivables	3,184	1,752	63	4,999
Financed service contracts	1,468	835	23	2,326
Total	\$5,946	\$3,786	\$ 140	\$9,872

We determine the adequacy of our allowance for credit loss by assessing the risks and losses inherent in our financing receivables by portfolio segment. The portfolio segment is based on the types of financing offered by us to our customers, which consist of the following: lease receivables, loan receivables, and financed service contracts.

Our internal credit risk ratings of 1 through 4 correspond to investment-grade ratings, while credit risk ratings of 5 and 6 correspond to non-investment grade ratings. Credit risk ratings of 7 and higher correspond to substandard ratings.

The following tables present the aging analysis of gross receivables, excluding residual value and less unearned income as of January 26, 2019 and July 28, 2018 (in millions):

DAYS PAST DUE
(INCLUDES BILLED AND
UNBILLED)

January 26, 2019	31-60	61-90	91+	Total Past Due	Current	Total	Nonaccrual Financing Receivables	Impaired Financing Receivables
Lease receivables	\$79	\$ 34	\$152	\$ 265	\$2,080	\$2,345	\$ 3	\$ 3
Loan receivables	73	39	235	347	4,579	4,926	28	28
Financed service contracts	74	38	280	392	2,006	2,398	2	2
Total	\$226	\$111	\$667	\$1,004	\$8,665	\$9,669	\$ 33	\$ 33

DAYS PAST DUE
(INCLUDES BILLED AND
UNBILLED)

July 28, 2018	31-60	61-90	91+	Total Past Due	Current	Total	Nonaccrual Financing Receivables	Impaired Financing Receivables
Lease receivables	\$72	\$ 27	\$155	\$ 254	\$2,293	\$2,547	\$ 9	\$ 9
Loan receivables	104	55	252	411	4,588	4,999	30	30
Financed service contracts	138	78	304	520	1,806	2,326	3	3
Total	\$314	\$160	\$711	\$1,185	\$8,687	\$9,872	\$ 42	\$ 42

Past due financing receivables are those that are 31 days or more past due according to their contractual payment terms. The data in the preceding tables is presented by contract, and the aging classification of each contract is based on the oldest outstanding receivable, and therefore past due amounts also include unbilled and current receivables within the same contract. The balances of either unbilled or current financing receivables included in the category of 91 days plus past due for financing receivables were \$396 million and \$503 million as of January 26, 2019 and July 28, 2018, respectively.

As of January 26, 2019, we had financing receivables of \$247 million, net of unbilled or current receivables, that were in the category of 91 days plus past due but remained on accrual status as they are well secured and in the process of collection. Such balance was \$182 million as of July 28, 2018.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Allowance for Credit Loss Rollforward

The allowances for credit loss and the related financing receivables are summarized as follows (in millions):

Three months ended January 26, 2019	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of October 27, 2018	\$131	\$ 60	\$ 8	\$199
Provisions (benefits)	(4)	4	1	1
Allowance for credit loss as of January 26, 2019	\$127	\$ 64	\$ 9	\$200
Six months ended January 26, 2019	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 28, 2018	\$135	\$ 60	\$ 10	\$205
Provisions (benefits)	(7)	4	(1)	(4)
Foreign exchange and other	(1)	—	—	(1)
Allowance for credit loss as of January 26, 2019	\$127	\$ 64	\$ 9	\$200
Three months ended January 27, 2018	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of October 28, 2017	\$160	\$ 106	\$ 23	\$289
Provisions (benefits)	3	(13)	(10)	(20)
Foreign exchange and other	2	1	—	3
Allowance for credit loss as of January 27, 2018	\$165	\$ 94	\$ 13	\$272
Six months ended January 27, 2018	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 29, 2017	\$162	\$ 103	\$ 30	\$295
Provisions (benefits)	1	(11)	(16)	(26)
Foreign exchange and other	2	2	(1)	3
Allowance for credit loss as of January 27, 2018	\$165	\$ 94	\$ 13	\$272

We assess the allowance for credit loss related to financing receivables on either an individual or a collective basis.

We consider various factors in evaluating lease and loan receivables and the earned portion of financed service contracts for possible impairment on an individual basis. These factors include our historical experience, credit quality and age of the receivable balances, and economic conditions that may affect a customer's ability to pay. When the evaluation indicates that it is probable that all amounts due pursuant to the contractual terms of the financing agreement, including scheduled interest payments, are unable to be collected, the financing receivable is considered impaired. All such outstanding amounts, including any accrued interest, will be assessed and fully reserved at the customer level. Our internal credit risk ratings are categorized as 1 through 10, with the lowest credit risk rating representing the highest quality financing receivables.

Typically, we also consider receivables with a risk rating of 8 or higher to be impaired and will include them in the individual assessment for allowance. These balances, as of January 26, 2019 and July 28, 2018, are presented under "(b) Credit Quality of Financing Receivables" above.

We evaluate the remainder of our financing receivables portfolio for impairment on a collective basis and record an allowance for credit loss at the portfolio segment level. When evaluating the financing receivables on a collective basis, we use expected default frequency rates published by a major third-party credit-rating agency as well as our own historical loss rate in the event of default, while also systematically giving effect to economic conditions,

concentration of risk, and correlation.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(d) Operating Leases

We provide financing of certain equipment through operating leases, and the amounts are included in property and equipment in the Consolidated Balance Sheets. Amounts relating to equipment on operating lease assets and the associated accumulated depreciation are summarized as follows (in millions):

	January 26, July 28,	
	2019	2018
Operating lease assets	\$ 529	\$ 356
Accumulated depreciation (370)	(238)	
Operating lease assets, net	\$ 159	\$ 118

Minimum future rentals on noncancelable operating leases as of January 26, 2019 are summarized as follows (in millions):

Fiscal Year	Amount
2019 (remaining six months)	\$ 81
2020	111
2021	48
2022	5
Total	\$ 245

9. Available-for-Sale Debt Investments and Equity Investments

The following table summarizes our available-for-sale debt investments and equity investments (in millions):

	January 26, July 28,	
	2019	2018
Available-for-sale debt investments	\$ 30,486	\$ 37,009
Marketable equity securities	62	605
Total investments	30,548	37,614
Non-marketable equity securities included in other assets ⁽¹⁾	1,133	978
Equity method investments included in other assets	115	118
Total	\$ 31,796	\$ 38,710

⁽¹⁾ We held equity interests in certain private equity funds of \$0.6 billion as of January 26, 2019 which are accounted for under the NAV practical expedient following the adoption of ASU 2016-01, Financial Instruments, in the first quarter of fiscal 2019.

(a) Summary of Available-for-Sale Debt Investments

The following tables summarize our available-for-sale debt investments (in millions):

January 26, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government securities	\$ 3,486	\$ —	\$ (14)	\$ 3,472
U.S. government agency securities	356	—	(2)	354
Non-U.S. government and agency securities	115	—	—	115
Corporate debt securities	25,103	16	(366)	24,753
U.S. agency mortgage-backed securities	1,475	1	(42)	1,434
Commercial paper	243	—	—	243
Certificates of deposit	115	—	—	115

Total ⁽¹⁾	\$ 30,893	\$ 17	\$ (424)	\$ 30,486
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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

July 28, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government securities	\$ 7,318	\$ —	\$ (43)	\$ 7,275
U.S. government agency securities	732	—	(5)	727
Non-U.S. government and agency securities	209	—	(1)	208
Corporate debt securities	27,765	44	(445)	27,364
U.S. agency mortgage-backed securities	1,488	—	(53)	1,435
Total ⁽¹⁾	\$ 37,512	\$ 44	\$ (547)	\$ 37,009

⁽¹⁾ Net unsettled investment purchases were \$4 million and net unsettled investment sales were \$1.5 billion as of January 26, 2019 and July 28, 2018, respectively and were included in other current assets and other current liabilities. Non-U.S. government and agency securities include agency and corporate debt securities that are guaranteed by non-U.S. governments.

The following table presents the gross realized gains and gross realized losses related to available-for-sale debt investments (in millions):

	Three Months Ended January 26, 2019		Six Months Ended January 26, 2019	
Gross realized gains	\$ 1	\$ 6	\$ 3	\$ 14
Gross realized losses	(6)	(102)	(14)	(106)
Total	\$(5)	\$(96)	\$(11)	\$(92)

The following tables present the breakdown of the available-for-sale debt investments with gross unrealized losses and the duration that those losses had been unrealized at January 26, 2019 and July 28, 2018 (in millions):

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 2 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
January 26, 2019						
U.S. government securities	\$ 6	\$ —	\$ 3,437	\$ (14)	\$ 3,443	\$ (14)
U.S. government agency securities	—	—	344	(2)	344	(2)
Non-U.S. government and agency securities	—	—	115	—	115	—
Corporate debt securities	5,849	(61)	15,108	(305)	20,957	(366)
U.S. agency mortgage-backed securities	47	—	1,216	(42)	1,263	(42)
Total	\$ 5,902	\$ (61)	\$ 20,220	\$ (363)	\$ 26,122	\$ (424)
	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 2 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
July 28, 2018						
U.S. government securities	\$ 2,966	\$ (20)	\$ 4,303	\$ (23)	\$ 7,269	\$ (43)
U.S. government agency securities	206	(2)	521	(3)	727	(5)
Non-U.S. government and agency securities	105	(1)	103	—	208	(1)

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Corporate debt securities	16,990	(344)	3,511	(101)	20,501	(445)
U.S. agency mortgage-backed securities	826	(24)	581	(29)	1,407	(53)
Total	\$ 21,093	\$ (391)	\$ 9,019	\$ (156)	\$ 30,112	\$ (547)

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

There were no impairment charges related to our available-for-sale debt investments for the second quarter and first six months of fiscal 2019, and for the corresponding periods of fiscal 2018, respectively. For available-for-sale debt investments that were in an unrealized loss position as of January 26, 2019, we have determined that no other-than-temporary impairments were required to be recognized.

The following table summarizes the maturities of our available-for-sale debt investments as of January 26, 2019 (in millions):

	Amortized Cost	Fair Value
Within 1 year	\$ 10,131	\$ 10,104
After 1 year through 5 years	17,704	17,426
After 5 years through 10 years	1,568	1,507
After 10 years	15	15
Mortgage-backed securities with no single maturity	1,475	1,434
Total	\$ 30,893	\$ 30,486

Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations.

(b) Summary of Equity Investments

We recorded adjustments to the carrying value of our non-marketable equity securities measured using the measurement alternative during the second quarter and first six months of fiscal 2019 as follows (in millions):

	Three Months Ended January 26, 2019	Six Months Ended January 26, 2019
Adjustments to non-marketable equity securities measured using the measurement alternative:		
Upward adjustments	\$ 14	\$ 24
Downward adjustments, including impairments	(2)	(18)
Net upward adjustments	\$ 12	\$ 6

Gains and losses recognized on our marketable and non-marketable equity securities for the second quarter and first six months of fiscal 2019 are summarized below (in millions):

	Three Months Ended January 26, 2019	Six Months Ended January 26, 2019
Net gains and losses recognized during the period on equity investments	\$ 67	\$ 75
Less: Net gains and losses recognized on equity investments sold	5	(7)
Unrealized gains and losses recognized during reporting period on equity securities still held at the reporting date	\$ 72	\$ 68

(c) Securities Lending

We periodically engage in securities lending activities with certain of our available-for-sale debt investments. These transactions are accounted for as a secured lending of the securities, and the securities are typically loaned only on an overnight basis. The average daily balance of securities lending was \$1.2 billion and \$0.4 billion for the first six months of fiscal 2019 and fiscal 2018, respectively. We require collateral equal to at least 102% of the fair market value of the loaned security and that the collateral be in the form of cash or liquid, high-quality assets. We engage in

these secured lending transactions only with highly creditworthy counterparties, and the associated portfolio custodian has agreed to indemnify us against collateral losses. We did not experience any losses in connection with the secured lending of securities during the periods presented. As of January 26, 2019 and July 28, 2018, we had no outstanding securities lending transactions.

(d) Variable Interest Entities

In the ordinary course of business, we have investments in privately held companies and provide financing to certain customers. These privately held companies and customers may be considered to be variable interest entities. We evaluate on an ongoing basis our investments in these privately held companies and our customer financings, and have determined that as of January 26, 2019,

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

except as disclosed in Note 1, there were no significant variable interest entities required to be consolidated in our Consolidated Financial Statements.

As of January 26, 2019, the carrying value of investments in privately held companies was \$1.25 billion, of which \$670 million of such investments are considered to be in variable interest entities which are unconsolidated. In addition, we have additional funding commitments of \$192 million related to these investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The carrying value of these investments and the additional funding commitments collectively represent our maximum exposure related to these variable interest entities.

10. Fair Value

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be either recorded or disclosed at fair value, we consider the principal or most advantageous market in which we would transact, and we also consider assumptions that market participants would use when pricing the asset or liability.

(a) Fair Value Hierarchy

The accounting guidance for fair value measurement requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard establishes a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is as follows:

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices that are observable for the asset or liability, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis were as follows (in millions):

	JANUARY 26, 2019			JULY 28, 2018		
	FAIR VALUE			FAIR VALUE		
	MEASUREMENTS			MEASUREMENTS		
	Level 1	Level 2	Total Balance	Level 1	Level 2	Total Balance
Assets:						
Cash equivalents:						
Money market funds	\$7,888	\$—	\$7,888	\$6,890	\$—	\$6,890
Commercial paper	—	99	99	—	—	—
Certificates of deposit	—	25	25	—	—	—
Available-for-sale debt investments:						
U.S. government securities	—	3,472	3,472	—	7,275	7,275
U.S. government agency securities	—	354	354	—	727	727
Non-U.S. government and agency securities	—	115	115	—	208	208
Corporate debt securities	—	24,753	24,753	—	27,364	27,364
U.S. agency mortgage-backed securities	—	1,434	1,434	—	1,435	1,435
Commercial paper	—	243	243	—	—	—
Certificates of deposit	—	115	115	—	—	—
Equity investments:						
Marketable equity securities	62	—	62	605	—	605
Derivative assets	—	23	23	—	2	2
Total	\$7,950	\$30,633	\$38,583	\$7,495	\$37,011	\$44,506
Liabilities:						
Derivative liabilities	\$—	\$40	\$40	\$—	\$74	\$74
Total	\$—	\$40	\$40	\$—	\$74	\$74

Level 1 marketable equity securities are determined by using quoted prices in active markets for identical assets.

Level 2 available-for-sale debt investments are priced using quoted market prices for similar instruments or nonbinding market prices that are corroborated by observable market data. We use inputs such as actual trade data, benchmark yields, broker/dealer quotes, and other similar data, which are obtained from quoted market prices, independent pricing vendors, or other sources, to determine the ultimate fair value of these assets and liabilities. We use such pricing data as the primary input to make our assessments and determinations as to the ultimate valuation of our investment portfolio and have not made, during the periods presented, any material adjustments to such inputs. We are ultimately responsible for the financial statements and underlying estimates. Our derivative instruments are primarily classified as Level 2, as they are not actively traded and are valued using pricing models that use observable market inputs. We did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Assets Measured at Fair Value on a Nonrecurring Basis

The following table presents gains and losses on assets that were measured at fair value on a nonrecurring basis (in millions):

	TOTAL GAINS (LOSSES) FOR THE THREE MONTHS ENDED January 26, 27, 2019	TOTAL GAINS (LOSSES) FOR THE SIX MONTHS ENDED January 26, 27, 2018
Non-marketable equity securities	\$ 12 \$ (18)	\$ 6 \$ (39)
Property held for sale—land and buildings	— 20	— 20
Total gains (losses) for nonrecurring measurements	\$ 12 \$ 2	\$ 6 \$ (19)

These assets were measured at fair value due to events or circumstances we identified as having significant impact on their fair value during the respective periods. The carrying value of our non-marketable equity securities recorded to fair value on a non-recurring basis is adjusted for observable transactions for identical or similar investments of the same issuer or impairment. These securities are classified as Level 3 in the fair value hierarchy because we estimate the value based on valuation methods using the observable transaction price at the transaction date and other unobservable inputs such as volatility, rights, and obligations of the securities we hold.

The fair value of property held for sale was measured with the assistance of third-party valuation models, which used discounted cash flow techniques as part of their analysis. The fair value measurement was categorized as Level 3, as significant unobservable inputs were used in the valuation report. The impairment charge as a result of the valuations, which represented the difference between the fair value less cost to sell and the carrying amount of the assets held for sale, was included in restructuring and other charges. The remaining carrying value of property held for sale that was impaired was zero as of January 27, 2018.

(d) Other Fair Value Disclosures

The fair value of short-term loan receivables and financed service contracts approximates their carrying value due to their short duration. The aggregate carrying value of long-term loan receivables and financed service contracts as of January 26, 2019 and July 28, 2018 was \$3.3 billion and \$3.6 billion, respectively. The estimated fair value of long-term loan receivables and financed service contracts approximates their carrying value. We use significant unobservable inputs in determining discounted cash flows to estimate the fair value of our long-term loan receivables and financed service contracts, and therefore they are categorized as Level 3.

As of January 26, 2019, the estimated fair value of our short-term debt approximates its carrying value due to the short maturities. As of January 26, 2019, the fair value of our senior notes and other long-term debt was \$26.5 billion with a carrying amount of \$25.6 billion. This compares to a fair value of \$26.4 billion and a carrying amount of \$25.6 billion as of July 28, 2018. The fair value of the senior notes and other long-term debt was determined based on observable market prices in a less active market and was categorized as Level 2 in the fair value hierarchy.

11. Borrowings

(a) Short-Term Debt

The following table summarizes our short-term debt (in millions, except percentages):

January 26, 2019 July 28, 2018

	Amount	Effective Rate		Amount	Effective Rate
Current portion of long-term debt	\$9,737	3.62 %		\$5,238	3.46 %

We repaid our senior notes due on February 15, 2019 for an aggregate principal amount of \$2.0 billion upon maturity.

We have a short-term debt financing program of up to \$10.0 billion through the issuance of commercial paper notes.

We use the proceeds from the issuance of commercial paper notes for general corporate purposes. We had no commercial paper notes outstanding as of January 26, 2019 and July 28, 2018. As of February 18, 2019, we had approximately \$2 billion of commercial paper notes outstanding.

The effective rates for the short- and long-term debt include the interest on the notes, the accretion of the discount, the issuance costs, and, if applicable, adjustments related to hedging.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Long-Term Debt

The following table summarizes our long-term debt (in millions, except percentages):

	Maturity Date	January 26, 2019		July 28, 2018	
		Amount	Effective Rate	Amount	Effective Rate
Senior notes:					
Floating-rate notes:					
Three-month LIBOR plus 0.50%	March 1, 2019	\$500	3.30%	\$500	2.86%
Three-month LIBOR plus 0.34%	September 20, 2019	500	3.17%	500	2.71%
Fixed-rate notes:					
4.95%	February 15, 2019	2,000	5.28%	2,000	5.17%
1.60%	February 28, 2019	1,000	1.67%	1,000	1.67%
2.125%	March 1, 2019	1,750	3.13%	1,750	2.71%
1.40%	September 20, 2019	1,500	1.48%	1,500	1.48%
4.45%	January 15, 2020	2,500	4.87%	2,500	4.52%
2.45%	June 15, 2020	1,500	2.54%	1,500	2.54%
2.20%	February 28, 2021	2,500	2.30%	2,500	2.30%
2.90%	March 4, 2021	500	3.28%	500	2.86%
1.85%	September 20, 2021	2,000	1.90%	2,000	1.90%
3.00%	June 15, 2022	500	3.55%	500	3.11%
2.60%	February 28, 2023	500	2.68%	500	2.68%
2.20%	September 20, 2023	750	2.27%	750	2.27%
3.625%	March 4, 2024	1,000	3.40%	1,000	2.98%
3.50%	June 15, 2025	500	3.71%	500	3.27%
2.95%	February 28, 2026	750	3.01%	750	3.01%
2.50%	September 20, 2026	1,500	2.55%	1,500	2.55%
5.90%	February 15, 2039	2,000	6.11%	2,000	6.11%
5.50%	January 15, 2040	2,000	5.67%	2,000	5.67%
Total		25,750		25,750	
Unaccreted discount/issuance costs		(107)		(116)	
Hedge accounting fair value adjustments		(13)		(65)	
Total		\$25,630		\$25,569	

Reported as:

Current portion of long-term debt	\$9,737	\$5,238
Long-term debt	15,893	20,331
Total	\$25,630	\$25,569

We entered into interest rate swaps in prior periods with an aggregate notional amount of \$6.75 billion designated as fair value hedges of certain of our fixed-rate senior notes. These swaps convert the fixed interest rates of the fixed-rate notes to floating interest rates based on the London InterBank Offered Rate ("LIBOR"). The gains and losses related to changes in the fair value of the interest rate swaps substantially offset changes in the fair value of the hedged portion of the underlying debt that are attributable to the changes in market interest rates. For additional information, see Note 12.

Interest is payable semiannually on each class of the senior fixed-rate notes and payable quarterly on the floating-rate notes. Each of the senior fixed-rate notes is redeemable by us at any time, subject to a make-whole premium. The senior notes rank at par with the commercial paper notes that may be issued in the future pursuant to our short-term

debt financing program, as discussed above under “(a) Short-Term Debt.” As of January 26, 2019, we were in compliance with all debt covenants.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of January 26, 2019, future principal payments for long-term debt, including the current portion, are summarized as follows (in millions):

Fiscal Year	Amount
2019 (remaining six months)	\$5,250
2020	6,000
2021	3,000
2022	2,500
2023	500
Thereafter	8,500
Total	\$25,750

(c) Credit Facility

On May 15, 2015, we entered into a credit agreement with certain institutional lenders that provides for a \$3.0 billion unsecured revolving credit facility that is scheduled to expire on May 15, 2020. Any advances under the credit agreement will accrue interest at rates that are equal to, based on certain conditions, either (i) the highest of (a) the Federal Funds rate plus 0.50%, (b) Bank of America's "prime rate" as announced from time to time, or (c) LIBOR, or a comparable or successor rate that is approved by the Administrative Agent ("Eurocurrency Rate"), for an interest period of one-month plus 1.00%, or (ii) the Eurocurrency Rate, plus a margin that is based on our senior debt credit ratings as published by Standard & Poor's Financial Services, LLC and Moody's Investors Service, Inc., provided that in no event will the Eurocurrency Rate be less than zero. We may also, upon the agreement of either the then-existing lenders or additional lenders not currently parties to the agreement, increase the commitments under the credit facility by up to an additional \$2.0 billion and/or extend the expiration date of the credit facility up to May 15, 2022.

This credit agreement requires that we comply with certain covenants, including that we maintain an interest coverage ratio as defined in the agreement. As of January 26, 2019, we were in compliance with the required interest coverage ratio and the other covenants, and we had not borrowed any funds under this credit facility.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Derivative Instruments

(a) Summary of Derivative Instruments

We use derivative instruments primarily to manage exposures to foreign currency exchange rate, interest rate, and equity price risks. Our primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates, interest rates, and equity prices. Our derivatives expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. We do, however, seek to mitigate such risks by limiting our counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored. Management does not expect material losses as a result of defaults by counterparties.

The fair values of our derivative instruments and the line items on the Consolidated Balance Sheets to which they were recorded are summarized as follows (in millions):

	DERIVATIVE ASSETS			DERIVATIVE LIABILITIES		
	Balance Sheet Line Item	January 26, 2019	January 27, 2018	Balance Sheet Line Item	January 26, 2019	January 27, 2018
Derivatives designated as hedging instruments:						
Foreign currency derivatives	Other current assets	\$ 1	\$ 1	Other current liabilities	\$ 8	\$ —
Interest rate derivatives	Other current assets	—	—	Other current liabilities	13	10
Interest rate derivatives	Other assets	12	—	Other long-term liabilities	15	62
Total		13	1		36	72
Derivatives not designated as hedging instruments:						
Foreign currency derivatives	Other current assets	10	1	Other current liabilities	4	2
Total		10	1		4	2
Total		\$ 23	\$ 2		\$ 40	\$ 74

The effects of our cash flow and net investment hedging instruments on other comprehensive income (OCI) and the Consolidated Statements of Operations are summarized as follows (in millions):

GAINS (LOSSES) RECOGNIZED IN OCI ON DERIVATIVES FOR THE THREE MONTHS ENDED (EFFECTIVE PORTION)	GAINS (LOSSES) RECLASSIFIED FROM AOCI INTO INCOME FOR THE THREE MONTHS ENDED (EFFECTIVE PORTION)		
	January 26, 2019	January 27, 2018	Line Item in Statements of Operations
Derivatives designated as cash flow hedging instruments:			
Foreign currency derivatives	\$ (6)	\$ 30	Revenue — product
			Revenue — service
			Cost of sales — service
			Operating expenses
Total	\$ (6)	\$ 30	

Derivatives designated as net investment hedging
instruments:

Foreign currency derivatives	\$ (1)	\$ (12)	Other income (loss), net	\$ —	\$ —
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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

GAINS (LOSSES) RECOGNIZED IN OCI ON DERIVATIVES FOR THE SIX MONTHS ENDED (EFFECTIVE PORTION)	January 26, 2019	January 27, 2018	Line Item in Statements of Operations	GAINS (LOSSES) RECLASSIFIED FROM AOCI INTO INCOME FOR THE SIX MONTHS ENDED (EFFECTIVE PORTION)	
				January 26, 2019	January 27, 2018
Derivatives designated as cash flow hedging instruments:					
Foreign currency derivatives	\$ (10)	\$ 38	Revenue — product	\$ 1	\$ —
			Revenue — service	2	—
			Cost of sales — service	(1)	7
			Operating expenses	(1)	24
Total	\$ (10)	\$ 38		\$ 1	\$ 31
Derivatives designated as net investment hedging instruments:					
Foreign currency derivatives	\$ 3	\$ (17)	Other income (loss), net	\$ —	\$ —

As of January 26, 2019, we estimate that approximately \$9 million of net derivative losses related to our cash flow hedges included in accumulated other comprehensive income (AOCI) will be reclassified into earnings within the next 12 months when the underlying hedged item impacts earnings.

The effect on the Consolidated Statements of Operations of derivative instruments designated as fair value hedges and the underlying hedged items is summarized as follows (in millions):

Derivatives Designated as Fair Value Hedging Instruments	Line Item in Statements of Operations	GAINS (LOSSES) ON DERIVATIVE INSTRUMENTS FOR THE THREE MONTHS ENDED		GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE THREE MONTHS ENDED	
		January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Interest rate derivatives	Interest expense	\$ 64	\$ (63)	\$ (61)	\$ 63
Equity derivatives	Other income (loss), net	—	(35)	—	35
Total		\$ 64	\$ (98)	\$ (61)	\$ 98
		GAINS (LOSSES) ON DERIVATIVE INSTRUMENTS FOR THE		GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE	

Derivatives Designated as Fair Value Hedging Instruments	Line Item in Statements of Operations	SIX MONTHS ENDED		SIX MONTHS ENDED	
		January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Interest rate derivatives	Interest expense	\$ 55	\$ (109)	\$ (52)	\$ 109
Equity derivatives	Other income (loss), net	—	(49)	—	49
Total		\$ 55	\$ (158)	\$ (52)	\$ 158

The effect on the Consolidated Statements of Operations of derivative instruments not designated as hedges is summarized as follows (in millions):

Derivatives Not Designated as Hedging Instruments	Line Item in Statements of Operations	GAINS (LOSSES) FOR THE THREE MONTHS ENDED		GAINS (LOSSES) FOR THE SIX MONTHS ENDED	
		January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Foreign currency derivatives	Other income (loss), net	\$ (1)	\$ 66	\$ (28)	\$ 73
Total return swaps—deferred compensation	Operating expenses	(9)	39	(33)	54
	Cost of sales — product	—	1	(1)	1
	Cost of sales — service	(1)	1	(2)	2
	Other income (loss), net	(4)	(3)	(8)	(5)
Equity derivatives	Other income (loss), net	—	2	1	3
Total		\$ (15)	\$ 106	\$ (71)	\$ 128

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The notional amounts of our outstanding derivatives are summarized as follows (in millions):

	January 26, 2019	July 28, 2018
Derivatives designated as hedging instruments:		
Foreign currency derivatives—cash flow hedges	\$ 890	\$ 147
Interest rate derivatives	6,750	6,750
Net investment hedging instruments	299	250
Derivatives not designated as hedging instruments:		
Foreign currency derivatives	2,643	2,298
Total return swaps—deferred compensation	536	566
Total	\$ 11,118	\$ 10,011

(b) Offsetting of Derivative Instruments

We present our derivative instruments at gross fair values in the Consolidated Balance Sheets. However, our master netting and other similar arrangements with the respective counterparties allow for net settlement under certain conditions, which are designed to reduce credit risk by permitting net settlement with the same counterparty. To further limit credit risk, we also enter into collateral security arrangements related to certain derivative instruments whereby cash is posted as collateral between the counterparties based on the fair market value of the derivative instrument. Information related to these offsetting arrangements is summarized as follows (in millions):

January 26, 2019

	GROSS AMOUNTS NOT OFFSET IN THE CONSOLIDATED BALANCE SHEETS BUT WITH LEGAL RIGHTS TO OFFSET		
	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Presented
Derivatives assets	\$23	\$ —	\$ 23
Derivatives liabilities	\$40	\$ —	\$ 40

July 28, 2018

	GROSS AMOUNTS NOT OFFSET IN THE CONSOLIDATED BALANCE SHEETS BUT WITH LEGAL RIGHTS TO OFFSET		
	Gross Amounts Recognized	Gross Amounts Offset	Net Amounts Presented
Derivatives assets	\$2	\$ —	\$ 2
Derivatives liabilities	\$74	\$ —	\$ 74

(c) Foreign Currency Exchange Risk

We conduct business globally in numerous currencies. Therefore, we are exposed to adverse movements in foreign currency exchange rates. To limit the exposure related to foreign currency changes, we enter into foreign currency

contracts. We do not enter into such contracts for speculative purposes.

We hedge forecasted foreign currency transactions related to certain revenues, operating expenses and service cost of sales with currency options and forward contracts. These currency options and forward contracts, designated as cash flow hedges, generally have maturities of less than 24 months. We assess effectiveness based on changes in total fair value of the derivatives. The effective portion of the derivative instrument's gain or loss is initially reported as a component of AOCI and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion, if any, of the gain or loss is reported in earnings immediately. During the periods presented, we did not discontinue any cash flow hedges for which it was probable that a forecasted transaction would not occur.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We enter into foreign exchange forward and option contracts to reduce the short-term effects of foreign currency fluctuations on assets and liabilities such as foreign currency receivables, including long-term customer financings, investments, and payables. These derivatives are not designated as hedging instruments. Gains and losses on the contracts are included in other income (loss), net, and substantially offset foreign exchange gains and losses from the remeasurement of intercompany balances or other current assets, investments, or liabilities denominated in currencies other than the functional currency of the reporting entity.

We hedge certain net investments in our foreign operations with forward contracts to reduce the effects of foreign currency fluctuations on our net investment in those foreign subsidiaries. These derivative instruments generally have maturities of up to six months.

(d) Interest Rate Risk

Interest Rate Derivatives, Investments Our primary objective for holding available-for-sale debt investments is to achieve an appropriate investment return consistent with preserving principal and managing risk. To realize these objectives, we may utilize interest rate swaps or other derivatives designated as fair value or cash flow hedges. As of January 26, 2019 and July 28, 2018, we did not have any outstanding interest rate derivatives related to our available-for-sale debt investments.

Interest Rate Derivatives Designated as Fair Value Hedges, Long-Term Debt In the first six months of fiscal 2019, we did not enter into any interest rate swaps. In prior fiscal years, we entered into interest rate swaps designated as fair value hedges related to fixed-rate senior notes that are due in fiscal 2019 through 2025. Under these interest rate swaps, we receive fixed-rate interest payments and make interest payments based on LIBOR plus a fixed number of basis points. The effect of such swaps is to convert the fixed interest rates of the senior fixed-rate notes to floating interest rates based on LIBOR. The gains and losses related to changes in the fair value of the interest rate swaps are included in interest expense and substantially offset changes in the fair value of the hedged portion of the underlying debt that are attributable to the changes in market interest rates. The fair value of the interest rate swaps was reflected in other assets and other current and long-term liabilities.

(e) Equity Price Risk

We may hold equity securities for strategic purposes or to diversify our overall investment portfolio. The marketable equity securities in our portfolio are subject to price risk. To manage our exposure to changes in the fair value of certain equity securities, we have periodically entered into equity derivatives that are designated as fair value hedges. The changes in the value of the hedging instruments are included in other income (loss), net, and offset the change in the fair value of the underlying hedged investment. In addition, we periodically enter into equity derivatives that are not designated as accounting hedges. The changes in the fair value of these derivatives are also included in other income (loss), net.

We are also exposed to variability in compensation charges related to certain deferred compensation obligations to employees. Although not designated as accounting hedges, we utilize derivatives such as total return swaps to economically hedge this exposure.

(f) Hedge Effectiveness

For the periods presented, amounts excluded from the assessment of hedge effectiveness were not material for fair value, cash flow, and net investment hedges. In addition, hedge ineffectiveness for fair value, cash flow, and net investment hedges was not material for any of the periods presented.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

13. Commitments and Contingencies

(a) Operating Leases

We lease office space in many U.S. locations. Outside the United States, larger leased sites include sites in Australia, Belgium, Canada, China, Germany, India, Japan, Mexico, Poland and the United Kingdom. We also lease equipment and vehicles. Future minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of January 26, 2019 are as follows (in millions):

Fiscal Year	Amount
2019 (remaining six months)	\$ 214
2020	331
2021	233
2022	163
2023	106
Thereafter	117
Total	\$ 1,164

(b) Purchase Commitments with Contract Manufacturers and Suppliers

We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to manage manufacturing lead times and help ensure adequate component supply, we enter into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by us or establish the parameters defining our requirements. A significant portion of our reported purchase commitments arising from these agreements consists of firm, noncancelable, and unconditional commitments. Certain of these purchase commitments with contract manufacturers and suppliers relate to arrangements to secure long-term pricing for certain product components for multi-year periods. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed.

The following table summarizes our purchase commitments with contract manufacturers and suppliers (in millions):

Commitments by Period	January 26, July 28,	
	2019	2018
Less than 1 year	\$ 5,366	\$ 5,407
1 to 3 years	731	710
3 to 5 years	180	360
Total	\$ 6,277	\$ 6,477

We record a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with the valuation of our excess and obsolete inventory. As of January 26, 2019 and July 28, 2018, the liability for these purchase commitments was \$148 million and \$159 million, respectively, and was included in other current liabilities.

(c) Other Commitments

In connection with our acquisitions, we have agreed to pay certain additional amounts contingent upon the achievement of certain agreed-upon technology, development, product, or other milestones or upon the continued employment with Cisco of certain employees of the acquired entities.

The following table summarizes the compensation expense related to acquisitions (in millions):

	Three Months		Six Months	
	Ended		Ended	
	January 26, January 27,		January 26, January 27,	
	2019	2018	2019	2018
Compensation expense related to acquisitions	\$ 66	\$ 46	\$ 175	\$ 88

As of January 26, 2019, we estimated that future cash compensation expense of up to \$528 million may be required to be recognized pursuant to the applicable business combination agreements.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We also have certain funding commitments, primarily related to our non-marketable equity and other investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The funding commitments were \$357 million and \$223 million as of January 26, 2019 and July 28, 2018, respectively.

(d) Product Warranties

The following table summarizes the activity related to the product warranty liability (in millions):

	Six Months Ended	
	January 26,	January 27,
	2019	2018
Balance at beginning of period	\$359	\$ 407
Provisions for warranties issued	297	287
Adjustments for pre-existing warranties	(5)	(21)
Settlements	(300)	(292)
Acquisitions and divestitures	(2)	—
Balance at end of period	\$349	\$ 381

We accrue for warranty costs as part of our cost of sales based on associated material product costs, labor costs for technical support staff, and associated overhead. Our products are generally covered by a warranty for periods ranging from 90 days to five years, and for some products we provide a limited lifetime warranty.

(e) Financing and Other Guarantees

In the ordinary course of business, we provide financing guarantees for various third-party financing arrangements extended to channel partners and end-user customers. Payments under these financing guarantee arrangements were not material for the periods presented.

Channel Partner Financing Guarantees We facilitate arrangements for third-party financing extended to channel partners, consisting of revolving short-term financing, generally with payment terms ranging from 60 to 90 days. These financing arrangements facilitate the working capital requirements of the channel partners, and, in some cases, we guarantee a portion of these arrangements. The volume of channel partner financing was \$7.3 billion and \$6.9 billion for the second quarter of fiscal 2019 and fiscal 2018, respectively, and was \$14.5 billion and \$13.6 billion for the first six months of fiscal 2019 and fiscal 2018, respectively. The balance of the channel partner financing subject to guarantees was \$1.3 billion and \$1.0 billion as of January 26, 2019 and July 28, 2018, respectively.

End-User Financing Guarantees We also provide financing guarantees for third-party financing arrangements extended to end-user customers related to leases and loans, which typically have terms of up to three years. The volume of financing provided by third parties for leases and loans as to which we had provided guarantees was \$6 million and \$12 million for the second quarter of fiscal 2019 and fiscal 2018, respectively, and was \$9 million and \$26 million for the first six months of fiscal 2019 and fiscal 2018, respectively.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Financing Guarantee Summary The aggregate amounts of financing guarantees outstanding at January 26, 2019 and July 28, 2018, representing the total maximum potential future payments under financing arrangements with third parties along with the related deferred revenue, are summarized in the following table (in millions):

	January 26, July 28, 2019 2018	
Maximum potential future payments relating to financing guarantees:		
Channel partner	\$ 338	\$ 277
End user	25	31
Total	\$ 363	\$ 308
Deferred revenue associated with financing guarantees:		
Channel partner	\$ (67)	\$ (94)
End user	(19)	(28)
Total	\$ (86)	\$ (122)
Maximum potential future payments relating to financing guarantees, net of associated deferred revenue	\$ 277	\$ 186

Other Guarantees Our other guarantee arrangements as of January 26, 2019 and July 28, 2018 that were subject to recognition and disclosure requirements were not material.

(f) Indemnifications

In the normal course of business, we indemnify other parties, including customers, lessors, and parties to other transactions with us, with respect to certain matters. We have agreed to indemnify against losses arising from a breach of representations or covenants or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim.

We have been asked to indemnify Time Warner Cable (“TWC”) for patent infringement claims asserted against it by Sprint Communications Company, L.P. (“Sprint”) in federal court in Kansas. Sprint alleges that TWC infringed certain Sprint patents by offering VoIP telephone services utilizing products provided by us generally in combination with those of other manufacturers. Sprint seeks monetary damages. Following a trial on March 3, 2017, a jury in Kansas found that TWC willfully infringed five Sprint patents and awarded Sprint \$139.8 million in damages. On March 14, 2017, the Kansas court declined Sprint's request for enhanced damages and entered judgment in favor of Sprint for \$139.8 million plus 1.06% in post-judgment interest. On May 30, 2017, the Court awarded Sprint \$20.3 million in pre-judgment interest and denied TWC's post-trial motions. TWC appealed to the U.S. Court of Appeals for the Federal Circuit, and, on November 30, 2018, a panel of the court affirmed the judgment. TWC filed a petition for rehearing en banc on January 29, 2019. Due to the uncertainty surrounding the litigation process, we are unable to reasonably estimate the ultimate outcome of the TWC litigation at this time. Should Sprint prevail in litigation, or TWC agree to a settlement, we, in accordance with our agreements, may have an obligation to indemnify TWC. At this time, we do not anticipate that our obligations regarding the final outcome would be material.

During the first six months of fiscal 2018, we recorded legal and indemnification settlement charges of \$127 million to product cost of sales related to prior indemnification matters resolved in fiscal 2018.

In addition, we have entered into indemnification agreements with our officers and directors, and our Amended and Restated Bylaws contain similar indemnification obligations to our agents.

It is not possible to determine the maximum potential amount under these indemnification agreements due to our limited history with prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by us under these agreements have not had a material effect on our operating results, financial position, or cash flows.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(g) Legal Proceedings

Brazil Brazilian authorities have investigated our Brazilian subsidiary and certain of our former employees, as well as a Brazilian importer of our products, and its affiliates and employees, relating to alleged evasion of import taxes and alleged improper transactions involving the subsidiary and the importer. Brazilian tax authorities have assessed claims against our Brazilian subsidiary based on a theory of joint liability with the Brazilian importer for import taxes, interest, and penalties. In addition to claims asserted by the Brazilian federal tax authorities in prior fiscal years, tax authorities from the Brazilian state of Sao Paulo have asserted similar claims on the same legal basis in prior fiscal years.

The asserted claims by Brazilian federal tax authorities that remain are for calendar years 2003 through 2007, and the asserted claims by the tax authorities from the state of Sao Paulo are for calendar years 2005 through 2007. The total asserted claims by Brazilian state and federal tax authorities aggregate to \$215 million for the alleged evasion of import and other taxes, \$1.4 billion for interest, and \$1.0 billion for various penalties, all determined using an exchange rate as of January 26, 2019. We have completed a thorough review of the matters and believe the asserted claims against our Brazilian subsidiary are without merit, and we are defending the claims vigorously. While we believe there is no legal basis for the alleged liability, due to the complexities and uncertainty surrounding the judicial process in Brazil and the nature of the claims asserting joint liability with the importer, we are unable to determine the likelihood of an unfavorable outcome against our Brazilian subsidiary and are unable to reasonably estimate a range of loss, if any. We do not expect a final judicial determination for several years.

SRI International On September 4, 2013, SRI International, Inc. ("SRI") asserted patent infringement claims against us in the U.S. District Court for the District of Delaware, accusing our products and services in the area of network intrusion detection of infringing two U.S. patents. SRI sought monetary damages of at least a reasonable royalty and enhanced damages. The trial on these claims began on May 2, 2016 and, on May 12, 2016, the jury returned a verdict finding willful infringement of the asserted patents. The jury awarded SRI damages of \$23.7 million. On May 25, 2017, the Court awarded SRI enhanced damages and attorneys' fees, entered judgment in the new amount of \$57.0 million, and ordered an ongoing royalty of 3.5% through the expiration of the patents in 2018. We have appealed to the United States Court of Appeals for the Federal Circuit on various grounds. We believe we have strong arguments to overturn the jury verdict and/or reduce the damages award. While the ultimate outcome of the case may still result in a loss, we do not expect it to be material.

Straight Path On September 24, 2014, Straight Path IP Group, Inc. ("Straight Path") asserted patent infringement claims against us in the U.S. District Court for the Northern District of California, accusing our 9971 IP Phone, Unified Communications Manager working in conjunction with 9971 IP Phones, and Video Communication Server products of infringement. All of the asserted patents have expired and Straight Path was therefore limited to seeking monetary damages for the alleged past infringement. On November 13, 2017, the Court granted our motion for summary judgment of non-infringement, thereby dismissing Straight Path's claims against us and cancelling a trial which had been set for March 12, 2018. Straight Path appealed to the U.S. Court of Appeal for the Federal Circuit, and, on January 23, 2019, the court summarily affirmed the finding of non-infringement.

Arista Networks, Inc. As reported in our Form 10-K for the fiscal year ended July 28, 2018 we received a payment of \$400 million from Arista Networks, Inc. ("Arista") in connection with the settlement of litigation. The payment was recognized in general and administrative expenses in our first quarter of fiscal 2019.

Oyster Optics On November 24, 2016, Oyster Optics, LLC ("Oyster") asserted patent infringement claims against us in the U.S. District Court for the Eastern District of Texas. Oyster alleges that certain Cisco ONS 15454 and NCS 2000 line cards infringe U.S. Patent No. 7,620,327 ("the '327 Patent"). Oyster seeks monetary damages. Oyster filed infringement claims based on the '327 Patent against other defendants, including ZTE, Nokia, NEC, Infinera, Huawei, Ciena, Alcatel-Lucent, and Fujitsu, and the court consolidated the cases alleging infringement of the '327 Patent. Oyster's cases against some of the defendants were resolved. The court vacated the November 4, 2018 trial date set for

Oyster's claims against Cisco and one other remaining defendant, pending resolution of Oyster's appeal of the court's summary judgment ruling dismissing certain of Oyster's claims. While we believe that we have strong non-infringement arguments and that the patent is invalid, if we do not prevail in the District Court, we believe damages ultimately assessed would not be material. Due to uncertainty surrounding patent litigation processes, we are unable to reasonably estimate the ultimate outcome of this litigation at this time. However, we do not anticipate that any final outcome of the dispute would be material.

In addition, we are subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including intellectual property litigation. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations, or cash flows. For additional information regarding intellectual property litigation, see "Part II, Item 1A. Risk Factors-We may be found to infringe on intellectual property rights of others" herein.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

14. Shareholders' Equity

(a) Cash Dividends on Shares of Common Stock

We declared and paid cash dividends of \$0.33 and \$0.29 per common share, or \$1.5 billion and \$1.4 billion, on our outstanding common stock for the second quarter of fiscal 2019 and fiscal 2018, respectively. We declared and paid cash dividends of \$0.66 and \$0.58 per common share, or \$3.0 billion and \$2.9 billion, on our outstanding common stock for the first six months of fiscal 2019 and fiscal 2018, respectively.

On February 13, 2019, our Board of Directors declared a quarterly dividend of \$0.35 per common share to be paid on April 24, 2019 to all shareholders of record as of the close of business on April 5, 2019. Any future dividends will be subject to the approval of our Board of Directors.

(b) Stock Repurchase Program

In September 2001, our Board of Directors authorized a stock repurchase program. On February 13, 2019, our Board of Directors authorized a \$15 billion increase to the stock repurchase program. The remaining authorized amount for stock repurchases under this program, including the additional authorization, is approximately \$24 billion with no termination date. A summary of the stock repurchase activity for fiscal 2019 and 2018 under the stock repurchase program, reported based on the trade date, is summarized as follows (in millions, except per-share amounts):

Quarter Ended	Shares	Weighted-Average Price per Share	Amount
Fiscal 2019			
January 26, 2019	111	\$ 45.09	\$ 5,016
October 27, 2018	109	\$ 46.01	\$ 5,026
Fiscal 2018			
July 28, 2018	138	\$ 43.58	\$ 6,015
April 28, 2018	140	\$ 42.83	\$ 6,015
January 27, 2018	103	\$ 39.07	\$ 4,011
October 28, 2017	51	\$ 31.80	\$ 1,620

There were \$160 million and \$180 million of stock repurchases that were pending settlement as of January 26, 2019 and July 28, 2018, respectively.

The purchase price for the shares of our stock repurchased is reflected as a reduction to shareholders' equity. We are required to allocate the purchase price of the repurchased shares as (i) a reduction to retained earnings and (ii) a reduction of common stock and additional paid-in capital.

(c) Preferred Stock

Under the terms of our Articles of Incorporation, the Board of Directors may determine the rights, preferences, and terms of our authorized but unissued shares of preferred stock.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

15. Employee Benefit Plans

(a) Employee Stock Incentive Plans

Stock Incentive Plan Program Description As of January 26, 2019, we had one stock incentive plan: the 2005 Stock Incentive Plan (the “2005 Plan”). In addition, we have, in connection with our acquisitions of various companies, assumed the share-based awards granted under stock incentive plans of the acquired companies or issued share-based awards in replacement thereof. Share-based awards are designed to reward employees for their long-term contributions to us and provide incentives for them to remain with Cisco. The number and frequency of share-based awards are based on competitive practices, operating results of Cisco, government regulations, and other factors. Our primary stock incentive plan is summarized as follows:

2005 Plan As of January 26, 2019, the maximum number of shares issuable under the 2005 Plan over its term was 694 million shares, plus shares from certain previous plans that are forfeited or are terminated for any other reason before being exercised or settled. If any awards granted under the 2005 Plan are forfeited or are terminated for any other reason before being exercised or settled, the unexercised or unsettled shares underlying the awards will again be available under the 2005 Plan. In addition, starting November 19, 2013, shares withheld by Cisco from an award other than a stock option or stock appreciation right to satisfy withholding tax liabilities resulting from such award will again be available for issuance, based on the fungible share ratio in effect on the date of grant.

Pursuant to an amendment approved by our shareholders on November 12, 2009, the number of shares available for issuance under the 2005 Plan is reduced by 1.5 shares for each share awarded as a stock grant or a stock unit, and any shares underlying awards outstanding from certain previous plans that expire unexercised at the end of their maximum terms become available for reissuance under the 2005 Plan. The 2005 Plan permits the granting of stock options, restricted stock, and restricted stock units (“RSUs”), the vesting of which may be performance-based or market-based along with the requisite service requirement, and stock appreciation rights to employees (including employee directors and officers), consultants of Cisco and its subsidiaries and affiliates, and non-employee directors of Cisco. Stock options and stock appreciation rights granted under the 2005 Plan have an exercise price of at least 100% of the fair market value of the underlying stock on the grant date. The expiration date for stock options and stock appreciation rights shall be no later than 10 years from the grant date.

The stock options will generally become exercisable for 20% or 25% of the option shares one year from the date of grant and then ratably over the following 48 months or 36 months, respectively. Time-based stock grants and time-based RSUs will generally vest over a four year term. The majority of the performance-based and market-based RSUs vests at the end of the three-year requisite service period or earlier if the award recipient meets certain retirement eligibility conditions. Certain performance-based RSUs, that are based on the achievement of financial and/or non-financial operating goals, typically vest upon the achievement of milestones (and may require subsequent service periods), with overall vesting of the shares underlying the award ranging from six months to three years. The Compensation and Management Development Committee of our Board of Directors has the discretion to use different vesting schedules. Stock appreciation rights may be awarded in combination with stock options or stock grants, and such awards shall provide that the stock appreciation rights will not be exercisable unless the related stock options or stock grants are forfeited. Stock grants may be awarded in combination with non-statutory stock options, and such awards may provide that the stock grants will be forfeited in the event that the related non-statutory stock options are exercised.

(b) Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan, which includes its subplan named the International Employee Stock Purchase Plan (together, the “Purchase Plan”), under which 721 million shares of our common stock have been reserved for issuance as of January 26, 2019. Eligible employees are offered shares through a 24-month offering period, which consists of four consecutive 6-month purchase periods. Employees may purchase a limited number of shares of our stock at a discount of up to 15% of the lesser of the market value at the beginning of the offering period or the end of

each 6-month purchase period. The Purchase Plan is scheduled to terminate on the earlier of (i) January 3, 2030 and (ii) the date on which all shares available for issuance under the Purchase Plan are sold pursuant to exercised purchase rights. Under the Purchase Plan, we issued 9 million shares during the second quarter and first six months of fiscal 2019 and 12 million shares during the second quarter and first six months of fiscal 2018. As of January 26, 2019, 169 million shares were available for issuance under the Purchase Plan.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Summary of Share-Based Compensation Expense

Share-based compensation expense consists primarily of expenses for stock options, stock purchase rights, restricted stock, and RSUs granted to employees. The following table summarizes share-based compensation expense (in millions):

	Three Months Ended		Six Months Ended	
	January 2019	January 27, 2018	January 26, 2019	January 27, 2018
Cost of sales—product	\$22	\$ 23	\$45	\$ 46
Cost of sales—service	31	31	64	65
Share-based compensation expense in cost of sales	53	54	109	111
Research and development	133	134	263	270
Sales and marketing	125	135	262	270
General and administrative	65	64	127	128
Restructuring and other charges	19	12	42	18
Share-based compensation expense in operating expenses	342	345	694	686
Total share-based compensation expense	\$395	\$ 399	\$803	\$ 797
Income tax benefit for share-based compensation	\$126	\$ 96	\$291	\$ 271

As of January 26, 2019, the total compensation cost related to unvested share-based awards not yet recognized was \$3.2 billion which is expected to be recognized over approximately 2.7 years on a weighted-average basis.

(d) Share-Based Awards Available for Grant

A summary of share-based awards available for grant is as follows (in millions):

	Share-Based Awards Available for Grant
BALANCE AT JULY 29, 2017	272
Restricted stock, stock units, and other share-based awards granted	(70)
Share-based awards canceled/forfeited/expired	18
Shares withheld for taxes and not issued	25
BALANCE AT JULY 28, 2018	245
Restricted stock, stock units, and other share-based awards granted	(37)
Share-based awards canceled/forfeited/expired	12
Shares withheld for taxes and not issued	15
Other	1
BALANCE AT JANUARY 26, 2019	236

For each share awarded as restricted stock or a restricted stock unit award under the 2005 Plan, 1.5 shares was deducted from the available share-based award balance. For restricted stock units that were awarded with vesting contingent upon the achievement of future financial performance or market-based metrics, the maximum awards that can be achieved upon full vesting of such awards were reflected in the preceding table.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(e) Restricted Stock and Stock Unit Awards

A summary of the restricted stock and stock unit activity, which includes time-based and performance-based or market-based RSUs, is as follows (in millions, except per-share amounts):

	Restricted Stock/ Stock Units	Weighted-Average Grant Date Fair Value per Share	Aggregate Fair Value
UNVESTED BALANCE AT JULY 29, 2017	141	\$ 26.94	
Granted	46	35.62	
Assumed from acquisitions	1	28.26	
Vested	(53)	26.02	\$ 1,909
Canceled/forfeited/other	(16)	28.37	
UNVESTED BALANCE AT JULY 28, 2018	119	30.56	
Granted	25	44.69	
Vested	(31)	27.99	\$ 1,453
Canceled/forfeited/other	(10)	31.20	
UNVESTED BALANCE AT JANUARY 26, 2019	103	\$ 34.66	

(f) Stock Option Awards

A summary of the stock option activity is as follows (in millions, except per-share amounts):

	STOCK OPTIONS OUTSTANDING	
	Number Outstanding	Weighted-Average Exercise Price per Share
BALANCE AT JULY 29, 2017	12	\$ 6.15
Assumed from acquisitions	3	8.20
Exercised	(8)	5.77
Canceled/forfeited/expired	(1)	8.75
BALANCE AT JULY 28, 2018	6	7.18
Exercised	(2)	6.79
BALANCE AT JANUARY 26, 2019	4	\$ 7.27

The following table summarizes significant ranges of outstanding and exercisable stock options as of January 26, 2019 (in millions, except years and share prices):

Range of Exercise Prices	STOCK OPTIONS OUTSTANDING			STOCK OPTIONS EXERCISABLE		
	Weighted- Average Remaining Contractual Life (in Years)	Weighted- Average Exercise Price per Share	Aggregate Intrinsic Value	Weighted- Average Exercise Price per Share	Aggregate Intrinsic Value	
\$ 0.01 – 35.00	4 5.3	\$ 7.27	\$ 167	3 \$ 7.11	\$ 130	

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on our closing stock price of \$46.13 as of January 25, 2019. The total number of in-the-money stock options exercisable as of January 26, 2019 was 3 million. As of July 28, 2018, 4 million outstanding stock options were exercisable and the weighted-average exercise price was \$6.84.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(g) Valuation of Employee Share-Based Awards

Time-based restricted stock units and performance-based restricted stock units ("PRSUs") that are based on our financial performance metrics or non-financial operating goals are valued using the market value of our common stock on the date of grant, discounted for the present value of expected dividends. On the date of grant, we estimated the fair value of the total shareholder return ("TSR") component of the PRSUs using a Monte Carlo simulation model. The assumptions for the valuation of time-based RSUs and PRSUs are summarized as follows:

	RESTRICTED STOCK UNITS		PERFORMANCE BASED RESTRICTED STOCK UNITS	
Three Months Ended	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Number of shares granted (in millions)	17	21	—	—
Grant date fair value per share	\$44.53	\$ 34.89	N/A	\$ 32.47
Weighted-average assumptions/inputs:				
Expected dividend yield	2.8 %	3.1 %	N/A	3.2 %
Range of risk-free interest rates	0.0% – 2.8%	0.0% – 2.1%	N/A	1.0%-1.8%
Range of expected volatilities for index	N/A	N/A	N/A	13.2%-81.0%
	RESTRICTED STOCK UNITS		PERFORMANCE BASED RESTRICTED STOCK UNITS	
Six Months Ended	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Number of shares granted (in millions)	23	28	2	3
Grant date fair value per share	\$44.48	\$ 33.50	\$47.00	\$ 31.31
Weighted-average assumptions/inputs:				
Expected dividend yield	2.8 %	3.2 %	2.8 %	3.6 %
Range of risk-free interest rates	0.0% – 2.9%	0.0% – 2.1%	2.1% – 3.0%	1.0%-1.8%
Range of expected volatilities for index	N/A	N/A	13.0% – 65.2%	13.2%-81.0%

The PRSUs granted during the periods presented are contingent on the achievement of our financial performance metrics, our comparative market-based returns, or the achievement of financial and non-financial operating goals. For the awards based on financial performance metrics or comparative market-based returns, generally 50% of the PRSUs are earned based on the average of annual operating cash flow and earnings per share goals established at the beginning of each fiscal year over a three-year performance period. Generally, the remaining 50% of the PRSUs are earned based on our TSR measured against the benchmark TSR of a peer group over the same period. Each PRSU recipient could vest in 0% to 150% of the target shares granted contingent on the achievement of our financial performance metrics or our comparative market-based returns and 0% to 100% of the target shares granted contingent on the achievement of non-financial operating goals.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

16. Comprehensive Income (Loss)

The components of AOCI, net of tax, and the other comprehensive income (loss), excluding noncontrolling interest, for the first six months of fiscal 2019 and fiscal 2018 are summarized as follows (in millions):

	Net Unrealized Gains (Losses) on Available-for-Sale Investments	Net Unrealized Gains (Losses) on Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Actuarial Gains (Losses)	Accumulated Other Comprehensive Income (Loss)
BALANCE AT JULY 28, 2018	\$ (310)	\$ (11)	\$ (528)	\$ (849)
Other comprehensive income (loss) before reclassifications attributable to Cisco Systems, Inc.	86	(9)	(184)	(107)
(Gains) losses reclassified out of AOCI	11	(1)	3	13
Tax benefit (expense)	—	2	(1)	1
Total change for the period	97	(8)	(182)	(93)
Effect of adoption of accounting standards	(168)	—	—	(168)
BALANCE AT JANUARY 26, 2019	\$ (381)	\$ (19)	\$ (710)	\$ (1,110)
	Net Unrealized Gains (Losses) on Available-for-Sale Investments	Net Unrealized Gains (Losses) on Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Actuarial Gains (Losses)	Accumulated Other Comprehensive Income (Loss)
BALANCE AT JULY 29, 2017	\$ 373	\$ 32	\$ (359)	\$ 46
Other comprehensive income (loss) before reclassifications attributable to Cisco Systems, Inc.	(174)	38	292	156
(Gains) losses reclassified out of AOCI	(91)	(31)	5	(117)
Tax benefit (expense)	3	1	(6)	(2)
Total change for the period	(262)	8	291	37
BALANCE AT JANUARY 27, 2018	\$ 111	\$ 40	\$ (68)	\$ 83

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The net gains (losses) reclassified out of AOCI into the Consolidated Statements of Operations, with line item location, during each period were as follows (in millions):

	Three Months Ended January 26, 2019		Six Months Ended January 26, 2019		
Comprehensive Income Components	2018	Income Before Taxes	2018	Income Before Taxes	Line Item in Statements of Operations
Net unrealized gains and losses on available-for-sale investments	\$ (5)	\$ 58	\$ (11)	\$ 91	Other income (loss), net
Net unrealized gains and losses on cash flow hedging instruments					
Foreign currency derivatives	1	—	1	—	Revenue—product
Foreign currency derivatives	1	—	2	—	Revenue—service
Foreign currency derivatives	(1)	4	(1)	7	Cost of sales—service
Foreign currency derivatives	—	14	(1)	24	Operating expenses
	1	18	1	31	
Cumulative translation adjustment and actuarial gains and losses	—	(4)	—	(5)	Operating expenses
Cumulative translation adjustment and actuarial gains and losses	(4)	—	(3)	—	Other income (loss), net
Total amounts reclassified out of AOCI	\$ (8)	\$ 72	\$ (13)	\$ 117	

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

17. Income Taxes

The following table provides details of income taxes (in millions, except percentages):

	Three Months Ended		Six Months Ended	
	January 26,	January 27,	January 26,	January 27,
	2019	2018	2019	2018
Income before provision for income taxes	\$3,343	\$3,232	\$7,252	\$6,194
Provision for income taxes	\$521	\$12,010	\$881	\$12,578
Effective tax rate	15.6 %	371.6 %	12.1 %	203.1 %

The effective tax rate for the first six months of fiscal 2019 includes a \$152 million tax benefit relating to indirect effects from adoption of ASC 606 at the beginning of fiscal 2019.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act significantly revises the U.S. corporate income tax by, among other things, lowering the statutory corporate income tax rate ("federal tax rate") from 35% to 21% effective January 1, 2018, implementing a modified territorial tax system, and imposing a mandatory one-time transition tax on accumulated earnings of foreign subsidiaries. The enactment of the Tax Act resulted in us recording a provisional tax expense of \$10.4 billion in fiscal 2018. In the second quarter of fiscal 2019, we completed our accounting relating to the Tax Act and recorded an additional \$58 million of tax expense. The total tax charge as a result of the Tax Act was \$10.5 billion, consisting of \$8.2 billion of tax expense for the U.S. transition tax on accumulated earnings of foreign subsidiaries, \$1.2 billion of foreign withholding tax and \$1.1 billion of tax expense for DTA re-measurement. The tax expense related to the U.S. transition tax on accumulated earnings in foreign subsidiaries is net of a \$0.9 billion benefit related to U.S. taxation of deemed foreign dividends in the transition fiscal year. This benefit may be reduced or eliminated in future legislation. If such legislation is enacted, we will record the impact of the legislation in the quarter of enactment.

The Tax Act includes a Global Intangible Low-Taxed Income ("GILTI") provision that imposes U.S. tax on certain foreign subsidiary income in the year it is earned. Our accounting policy is to treat tax on GILTI as a current period cost included in tax expense in the year incurred.

As of January 26, 2019, we had \$1.8 billion of unrecognized tax benefit, of which \$1.6 billion, if recognized, would favorably impact the effective tax rate. We regularly engage in discussions and negotiations with tax authorities regarding tax matters in various jurisdictions. We believe it is reasonably possible that certain federal, foreign and state tax matters may be concluded in the next 12 months. Specific positions that may be resolved include issues involving transfer pricing and various other matters. We estimate that the unrecognized tax benefits at January 26, 2019 could be reduced by approximately \$50 million in the next 12 months.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

18. Segment Information and Major Customers

(a) Revenue and Gross Margin by Segment

We conduct business globally and are primarily managed on a geographic basis consisting of three segments: the Americas, EMEA, and APJC. Our management makes financial decisions and allocates resources based on the information it receives from our internal management system. Sales are attributed to a segment based on the ordering location of the customer. We do not allocate research and development, sales and marketing, or general and administrative expenses to our segments in this internal management system because management does not include the information in our measurement of the performance of the operating segments. In addition, we do not allocate amortization and impairment of acquisition-related intangible assets, share-based compensation expense, significant litigation settlements and other contingencies, charges related to asset impairments and restructurings, and certain other charges to the gross margin for each segment because management does not include this information in our measurement of the performance of the operating segments.

Summarized financial information by segment for the second quarter and the first six months of fiscal 2019 and fiscal 2018, based on our internal management system and as utilized by our Chief Operating Decision Maker ("CODM"), is as follows (in millions):

	Three Months Ended January 26, 2019		Six Months Ended January 27, 2019	
	2019	2018	2019	2018
Revenue:				
Americas	\$7,352	\$ 7,004	\$15,103	\$ 14,354
EMEA	3,223	3,062	6,447	5,971
APJC	1,872	1,820	3,968	3,698
Total	\$12,446	\$ 11,887	\$25,518	\$ 24,023
Gross margin:				
Americas	\$4,796	\$ 4,614	\$9,866	\$ 9,336
EMEA	2,070	1,977	4,141	3,816
APJC	1,109	1,094	2,309	2,259
Segment total	7,975	7,685	16,316	15,411
Unallocated corporate items (202)	(187)	(397)	(486)	
Total	\$7,773	\$ 7,498	\$15,919	\$ 14,925

Amounts may not sum and percentages may not recalculate due to rounding.

Revenue in the United States was \$6.4 billion and \$6.1 billion for the second quarter of fiscal 2019 and fiscal 2018, respectively, and \$13.3 billion and \$12.6 billion for the first six months of fiscal 2019 and fiscal 2018, respectively.

(b) Revenue for Groups of Similar Products and Services

We design, manufacture, and sell Internet Protocol (IP)-based networking and other products related to the communications and information technology (IT) industry and provide services associated with these products and their use.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table presents revenue for groups of similar products and services (in millions):

	Three Months Ended		Six Months Ended	
	January 26, 2019		January 27, 2018	
	2019	2018	2019	2018
Revenue:				
Infrastructure Platforms	\$7,128	\$ 6,710	\$14,770	\$ 13,690
Applications	1,465	1,184	2,884	2,387
Security	658	557	1,308	1,142
Other Products	22	258	200	544
Total Product	9,273	8,709	19,163	17,763
Services	3,173	3,178	6,355	6,260
Total ⁽¹⁾	\$12,446	\$ 11,887	\$25,518	\$ 24,023

⁽¹⁾ Includes SPVSS business revenue of \$0 and \$230 million for the second quarter of fiscal 2019 and 2018, respectively, and \$168 million and \$478 million for the first six months of fiscal 2019 and fiscal 2018, respectively.

(c) Additional Segment Information

The majority of our assets was attributable to our U.S. operations as of each of January 26, 2019 and July 28, 2018. Property and equipment information is based on the physical location of the assets. The following table presents property and equipment information for geographic areas (in millions):

	January 26, 2019		July 28, 2018	
Property and equipment, net:				
United States	\$ 2,394	\$ 2,487		
International	537	519		
Total	\$ 2,931	\$ 3,006		

19. Net Income (Loss) per Share

The following table presents the calculation of basic and diluted net income (loss) per share (in millions, except per-share amounts):

	Three Months Ended		Six Months Ended	
	January 26, 2019		January 27, 2018	
	2019	2018	2019	2018
Net income (loss)	\$2,822	\$ (8,778)	\$6,371	\$ (6,384)
Weighted-average shares—basic	4,470	4,924	4,517	4,942
Effect of dilutive potential common shares	35	—	40	—
Weighted-average shares—diluted	4,505	4,924	4,557	4,942
Net income (loss) per share—basic	\$0.63	\$ (1.78)	\$1.41	\$ (1.29)
Net income (loss) per share—diluted	\$0.63	\$ (1.78)	\$1.40	\$ (1.29)

Employee equity share options, unvested shares, and similar equity instruments granted and assumed by Cisco are treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options, unvested restricted stock, and restricted stock units. The dilutive effect of such equity awards is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options and the amount of compensation cost for future service that has not yet recognized are collectively assumed to be used to repurchase shares.

We excluded antidilutive employee-share based awards of 27 million and 28 million for the second quarter and first six months of fiscal 2019, respectively. For the second quarter and first six months of fiscal 2018, we excluded the impact of potentially dilutive common shares from the calculation of net income (loss) per share as the inclusion would have an antidilutive effect.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). All statements other than statements of historical facts are statements that could be deemed forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "momentum," "seeks," "estimates," "endeavors," "strives," "may," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those under "Part II, Item 1A. Risk Factors," and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

OVERVIEW

Cisco designs and sells a broad range of technologies that have been powering the Internet since 1984. Across networking, security, collaboration, applications and the cloud, our evolving intent-based technologies are constantly learning and adapting to provide customers with a highly secure, intelligent platform for their digital business. A summary of our results is as follows (in millions, except percentages and per-share amounts):

	Three Months Ended				Six Months Ended			
	January 26, 2019	January 27, 2018	Variance		January 26, 2019	January 27, 2018	Variance	
Revenue ⁽¹⁾	\$12,446	\$11,887	5 %		\$25,518	\$24,023	6 %	
Gross margin percentage	62.5 %	63.1 %	(0.6)	pts	62.4 %	62.1 %	0.3	pts
Research and development	\$1,557	\$1,549	1 %		\$3,165	\$3,116	2 %	
Sales and marketing	\$2,271	\$2,235	2 %		\$4,681	\$4,569	2 %	
General and administrative	\$509	\$483	5 %		\$720	\$1,040	(31)%	
Total research and development, sales and marketing, general and administrative	\$4,337	\$4,267	2 %		\$8,566	\$8,725	(2)%	
Total as a percentage of revenue	34.8 %	35.9 %	(1.1)	pts	33.6 %	36.3 %	(2.7)	pts
Amortization of purchased intangible assets included in operating expenses	\$39	\$60	(35)%		\$73	\$121	(40)%	
Restructuring and other charges included in operating expenses	\$186	\$98	90 %		\$264	\$250	6 %	
Interest and other income (loss), net	\$132	\$159	(17)%		\$236	\$365	(35)%	
Operating income as a percentage of revenue	25.8 %	25.9 %	(0.1)	pts	27.5 %	24.3 %	3.2	pts
Income tax percentage	15.6 %	371.6 %	NM		12.1 %	203.1 %	NM	
Net income (loss) ⁽²⁾	\$2,822	\$(8,778)	NM		\$6,371	\$(6,384)	NM	
Net income (loss) as a percentage of revenue ⁽²⁾	22.7 %	(73.8)%	NM		25.0 %	(26.6)%	NM	
Earnings (loss) per share—diluted	\$0.63	\$(1.78)	NM		\$1.40	\$(1.29)	NM	

NM - Not meaningful; we recognized a net loss for the second quarter and first six months of fiscal 2018 related to the enactment of the Tax Cuts and Jobs Act.

We adopted ASC 606 in the first quarter of fiscal 2019 using the modified retrospective method. See Note 2 to the Consolidated Financial Statements for impact of this adoption on our operating results for the second quarter and first six months of fiscal 2019.

⁽¹⁾ During the second quarter of fiscal 2019, we completed the sale of our Service Provider Video Software Solutions (“SPVSS”) business. As a result, revenue from this business will not recur in future periods. Includes SPVSS business revenue of \$0 and \$230 million for the second quarter of fiscal 2019 and 2018, respectively, and \$168 million and \$478 million for the first six months of fiscal 2019 and 2018, respectively.

⁽²⁾ Second quarter and first six months of fiscal 2018 results include an \$11.1 billion charge related to the enactment of the Tax Cuts and Jobs Act.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

In the second quarter of fiscal 2019, we delivered revenue growth across all geographies and product areas, solid margins and operating cash flow. We remain focused on accelerating innovation across our portfolio, and we believe that we have made continued progress on our strategic priorities. Our product revenue reflected growth in Infrastructure Platforms, Applications and Security, and we continued to make progress in the transition of our business model to increased software and subscriptions. Notwithstanding the second quarter fiscal 2019 results, we continue to operate in a challenging and highly competitive environment. While the overall environment remains uncertain, we continue to aggressively invest in priority areas with the objective of driving profitable growth over the long term.

Total revenue increased by 5% compared with the second quarter of fiscal 2018. Within total revenue, product revenue increased by 6% and service revenue was flat. In the second quarter of fiscal 2019, on October 28, 2018, we completed the sale of our SPVSS business. Total revenue for the second quarter of fiscal 2019 increased 7% not including revenue from SPVSS business in the prior year period. Total gross margin decreased by 0.6 percentage points, driven by unfavorable impacts from pricing and productivity. As a percentage of revenue, research and development, sales and marketing, and general and administrative expenses, collectively, decreased by 1.1 percentage points. Operating income as a percentage of revenue decreased by 0.1 percentage points. The net loss and net loss per share in the prior year period were driven by the one-time transition tax on accumulated earnings of foreign subsidiaries, foreign withholding taxes, and re-measurement of net deferred tax assets and liabilities recorded during the second quarter of fiscal 2018.

In terms of our geographic segments, revenue from the Americas increased \$348 million, EMEA revenue increased by \$161 million, and revenue in our APJC segment increased by \$52 million. These increases reflect broad strength across several countries within these segments. The "BRICM" countries experienced product revenue growth of 5% in the aggregate, driven by increased product revenue in the emerging countries of Mexico, India, Brazil and Russia of 35%, 18%, 14% and 4%, respectively, partially offset by a product revenue decrease of 16% in China.

From a customer market standpoint, we experienced product revenue growth in the public sector, enterprise and commercial markets, partially offset by a product revenue decline in the service provider market.

From a product category perspective, total product revenue, not including SPVSS products in the prior year period, increased 9% year over year. The increase was driven by a 6% product revenue increase in Infrastructure Platforms and solid product revenue growth in Applications and Security, which grew by 24% and 18% respectively.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Total revenue increased 6%, with product revenue increasing 8% and service revenue increasing 2%. Total gross margin increased by 0.3 percentage points due to productivity benefits and a \$127 million legal and indemnification settlement charge recorded in the first six months of fiscal 2018, partially offset by unfavorable impacts from pricing. As a percentage of revenue, research and development, sales and marketing, and general and administrative expenses collectively decreased by 2.7 percentage points due to lower general and administrative expenses. General and administrative expenses decreased due to a benefit from the \$400 million litigation settlement with Arista in the first quarter of fiscal 2019. Operating income as a percentage of revenue increased by 3.2 percentage points. The net loss and net loss per share in the prior year period were driven by similar factors as discussed in the three-month period immediately above.

Strategy and Priorities

As our customers add billions of new connections to their enterprises, and as more applications move to a multi-cloud environment, we believe the network continues to be extremely critical. We believe that our customers are looking for intent-based networks that provide meaningful business value through automation, security, and analytics across private, hybrid, and multi-cloud environments. Our vision is to deliver highly secure, software-defined, automated and intelligent platforms for our customers. Our strategic priorities include the following: accelerating our pace of innovation, increasing the value of the network, and transforming our business model.

For additional discussion of our strategy and priorities, see Item 1. Business in our Annual Report on Form 10-K for the year ended July 28, 2018.

Other Key Financial Measures

The following is a summary of our other key financial measures for the second quarter and first six months of fiscal 2019 (in millions):

	January 26, July 28, 2019 2018	
Cash and cash equivalents and investments	\$ 40,383	\$46,548
Deferred revenue	\$ 17,261	\$19,685
Inventories	\$ 1,701	\$1,846
	Six Months Ended January 26, January 27, 2019 2018	
Cash provided by operating activities	\$7,560	\$ 7,150
Repurchases of common stock—stock repurchase program	\$10,042	\$ 5,631
Dividends	\$2,970	\$ 2,861

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions, and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 2 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended July 28, 2018, as updated as applicable in Note 2 to the Consolidated Financial Statements herein, describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. The accounting policies described below are significantly affected by critical accounting estimates. Such accounting policies require significant judgments, assumptions, and estimates used in the preparation of the Consolidated Financial Statements, and actual results could differ materially from the amounts reported based on these policies.

Revenue Recognition

In May 2014, the FASB issued ASC 606, Revenue from Contracts with Customers, a new accounting standard related to revenue recognition. ASC 606 supersedes nearly all U.S. GAAP on revenue recognition and eliminated industry-specific guidance. The underlying principle of ASC 606 is to recognize revenue when a customer obtains control of promised goods or services at an amount that reflects the consideration that is expected to be received in exchange for those goods or services.

ASC 606 allowed two methods of adoption: i) retrospectively to each prior period presented ("full retrospective method"), or ii) retrospectively with the cumulative effect recognized in retained earnings as of the date of adoption ("modified retrospective method"). At the beginning of our first quarter of fiscal 2019, we adopted ASC 606 using the modified retrospective method to those contracts that were not completed as of July 28, 2018.

ASC 606 primarily impacted our revenue recognition for software arrangements and sales to two-tier distributors. In both areas, the new standard accelerates the recognition of revenue.

We enter into contracts with customers that can include various combinations of products and services which are generally distinct and accounted for as separate performance obligations. As a result, our contracts may contain multiple performance obligations. We determine whether arrangements are distinct based on whether the customer can benefit from the product or service on its own or together with other resources that are readily available and whether our commitment to transfer the product or service to the customer is separately identifiable from other obligations in the contract. We classify our hardware, perpetual software licenses, and SaaS as distinct performance obligations. Term software licenses represent multiple obligations, which include software licenses and software maintenance. In transactions where we deliver hardware or software, we are typically the principal and we record revenue and costs of goods sold on a gross basis.

We recognize revenue upon transfer of control of promised goods or services in a contract with a customer in an amount that reflects the consideration we expect to receive in exchange for those products or services. Transfer of control occurs once the customer has the contractual right to use the product, generally upon shipment or once delivery and risk of loss has transferred to the customer. Transfer of control can also occur over time for software maintenance and services as the customer receives the benefit over the contract term. Our hardware and perpetual software licenses are distinct performance obligations where revenue is recognized upfront upon transfer of control. Term software licenses include multiple performance obligations where the term licenses are recognized upfront upon transfer of control, with the associated software maintenance revenue recognized ratably over the contract term as services and software updates are provided. SaaS arrangements have one distinct performance obligation which is satisfied over time with revenue recognized ratably over the contract term as the customer consumes the services. On our product sales, we record consideration from shipping and handling on a gross basis within net product sales. We record our revenue net of any associated sales taxes.

Revenue is allocated among these performance obligations in a manner that reflects the consideration that we expect to be entitled to for the promised goods or services based on standalone selling prices (SSP). SSP is estimated for each distinct performance obligation and judgment may be required in their determination. The best evidence of SSP is the

observable price of a product or service when we sell the goods separately in similar circumstances and to similar customers. In instances where SSP is not directly observable, we determine SSP using information that may include market conditions and other observable inputs.

We apply judgment in determining the transaction price as we may be required to estimate variable consideration when determining the amount of revenue to recognize. Variable consideration includes various rebate, cooperative marketing, and other incentive programs that we offer to our distributors, partners and customers. When determining the amount of revenue to recognize, we estimate the expected usage of these programs, applying the expected value or most likely estimate and update the estimate at each reporting period as actual utilization becomes available. We also consider the customers' right of return in determining the transaction price, where applicable. If actual credits received by distributors under these programs were to deviate significantly from our estimates, which are based on historical experience, our revenue could be adversely affected.

See Notes 2 and 3 to the Consolidated Financial Statements for more details.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Allowances for Receivables and Sales Returns

The allowances for receivables were as follows (in millions, except percentages):

	January 26, 2019		July 28, 2018	
Allowance for doubtful accounts	\$	135	\$	129
Percentage of gross accounts receivable	3.5	%	2.3	%
Allowance for credit loss—lease receivables	\$	127	\$	135
Percentage of gross lease receivables ⁽¹⁾	4.8	%	4.7	%
Allowance for credit loss—loan receivables	\$	64	\$	60
Percentage of gross loan receivables	1.3	%	1.2	%

⁽¹⁾ Calculated as allowance for credit loss on lease receivables as a percentage of gross lease receivables and residual value before unearned income.

The allowance for doubtful accounts is based on our assessment of the collectibility of customer accounts. We regularly review the adequacy of these allowances by considering internal factors such as historical experience, credit quality and age of the receivable balances as well as external factors such as economic conditions that may affect a customer's ability to pay as well as historical and expected default frequency rates, which are published by major third-party credit-rating agencies and are updated on a quarterly basis. We also consider the concentration of receivables outstanding with a particular customer in assessing the adequacy of our allowances for doubtful accounts. If a major customer's creditworthiness deteriorates, if actual defaults are higher than our historical experience, or if other circumstances arise, our estimates of the recoverability of amounts due to us could be overstated, and additional allowances could be required, which could have an adverse impact on our operating results.

The allowance for credit loss on financing receivables is also based on the assessment of collectibility of customer accounts. We regularly review the adequacy of the credit allowances determined either on an individual or a collective basis. When evaluating the financing receivables on an individual basis, we consider historical experience, credit quality and age of receivable balances, and economic conditions that may affect a customer's ability to pay. When evaluating financing receivables on a collective basis, we use expected default frequency rates published by a major third-party credit-rating agency as well as our own historical loss rate in the event of default, while also systematically giving effect to economic conditions, concentration of risk and correlation. Determining expected default frequency rates and loss factors associated with internal credit risk ratings, as well as assessing factors such as economic conditions, concentration of risk, and correlation, are complex and subjective. Our ongoing consideration of all these factors could result in an increase in our allowance for credit loss in the future, which could adversely affect our operating results. Both accounts receivable and financing receivables are charged off at the point when they are considered uncollectible.

A reserve for future sales returns is established based on historical trends in product return rates. The reserve for future sales returns as of January 26, 2019 and July 28, 2018 was \$92 million and \$123 million, respectively, and was recorded as a reduction of our accounts receivable and revenue. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

Inventory Valuation and Liability for Purchase Commitments with Contract Manufacturers and Suppliers

Inventory is written down based on excess and obsolete inventories, determined primarily by future demand forecasts. Inventory write-downs are measured as the difference between the cost of the inventory and market, based upon assumptions about future demand, and are charged to the provision for inventory, which is a component of our cost of sales. At the point of the loss recognition, a new, lower cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

We record a liability for firm, noncancelable, and unconditional purchase commitments with contract manufacturers and suppliers for quantities in excess of our future demand forecasts consistent with the valuation of our excess and obsolete inventory.

Our provision for inventory was \$23 million and \$31 million for the first six months of fiscal 2019 and 2018, respectively. The provision for the liability related to purchase commitments with contract manufacturers and suppliers was \$48 million and \$44 million for the first six months of fiscal 2019 and 2018, respectively. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to increase our inventory write-downs, and our liability for purchase commitments with contract manufacturers and suppliers, and accordingly our profitability, could be adversely affected. We regularly evaluate our exposure for inventory write-downs and the adequacy of our liability for purchase commitments.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Loss Contingencies and Product Warranties

We are subject to the possibility of various losses arising in the ordinary course of business. We consider the likelihood of impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate information available to us to determine whether such accruals should be made or adjusted and whether new accruals are required.

Third parties, including customers, have in the past and may in the future assert claims or initiate litigation related to exclusive patent, copyright, trademark, and other intellectual property rights to technologies and related standards that are relevant to us. These assertions have increased over time as a result of our growth and the general increase in the pace of patent claims assertions, particularly in the United States. If any infringement or other intellectual property claim made against us by any third party is successful, or if we fail to develop non-infringing technology or license the proprietary rights on commercially reasonable terms and conditions, our business, operating results, and financial condition could be materially and adversely affected.

Our products are generally covered by a warranty for periods ranging from 90 days to five years, and for some products we provide a limited lifetime warranty. We accrue for warranty costs as part of our cost of sales based on associated material costs, technical support labor costs, and associated overhead. Material cost is estimated based primarily upon historical trends in the volume of product returns within the warranty period and the cost to repair or replace the equipment. Technical support labor cost is estimated based primarily upon historical trends in the rate of customer cases and the cost to support the customer cases within the warranty period. Overhead cost is applied based on estimated time to support warranty activities.

If we experience an increase in warranty claims compared with our historical experience, or if the cost of servicing warranty claims is greater than expected, our profitability could be adversely affected.

Impairment of Investments

We recognize an impairment charge when the declines in the fair values of our available-for-sale debt investments below their cost basis are judged to be other than temporary. The ultimate value realized on these securities, to the extent unhedged, is subject to market price volatility until they are sold.

If the fair value of a debt security is less than its amortized cost, we assess whether the impairment is other than temporary. An impairment is considered other than temporary if (i) we have the intent to sell the security, (ii) it is more likely than not that we will be required to sell the security before recovery of its entire amortized cost basis, or (iii) we do not expect to recover the entire amortized cost of the security. If an impairment is considered other than temporary based on (i) or (ii) described in the prior sentence, the entire difference between the amortized cost and the fair value of the security is recognized in earnings. If an impairment is considered other than temporary based on condition (iii), the amount representing credit loss, defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis of the debt security, will be recognized in earnings, and the amount relating to all other factors will be recognized in other comprehensive income (OCI). In estimating the amount and timing of cash flows expected to be collected, we consider all available information, including past events, current conditions, the remaining payment terms of the security, the financial condition of the issuer, expected defaults, and the value of underlying collateral.

We hold non-marketable equity and other investments, some of which are in the startup or development stages. As of January 26, 2019, our non-marketable equity and other investments were \$1.3 billion, compared with \$1.1 billion as of July 28, 2018, and were included in other assets. We monitor these investments for events or circumstances indicative of potential impairment, and we make appropriate reductions in carrying values if we determine that an impairment charge is required, based primarily on the financial condition and near-term prospects of these companies. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize.

Goodwill and Purchased Intangible Asset Impairments

Our methodology for allocating the purchase price relating to purchase acquisitions is determined through established valuation techniques. Goodwill represents a residual value as of the acquisition date, which in most cases results in measuring goodwill as an excess of the purchase consideration transferred plus the fair value of any noncontrolling interest in the acquired company over the fair value of net assets acquired, including contingent consideration. We perform goodwill impairment tests on an annual basis in the fourth fiscal quarter and between annual tests in certain circumstances for each reporting unit. The assessment of fair value for goodwill and purchased intangible assets is based on factors that market participants would use in an orderly transaction in accordance with the new accounting guidance for the fair value measurement of nonfinancial assets.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

The goodwill recorded in the Consolidated Balance Sheets as of January 26, 2019 and July 28, 2018 was \$33.3 billion and \$31.7 billion, respectively. In response to changes in industry and market conditions, we could be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill. There was no impairment of goodwill in each of the first six months of fiscal 2019 and 2018.

The fair value of acquired technology and patents, as well as acquired technology under development, is determined at acquisition date primarily using the income approach, which discounts expected future cash flows to present value. The discount rates used in the present value calculations are typically derived from a weighted-average cost of capital analysis and then adjusted to reflect risks inherent in the development lifecycle as appropriate. We consider the pricing model for products related to these acquisitions to be standard within the high-technology communications industry, and the applicable discount rates represent the rates that market participants would use for valuation of such intangible assets.

We make judgments about the recoverability of purchased intangible assets with finite lives whenever events or changes in circumstances indicate that an impairment may exist. Recoverability of purchased intangible assets with finite lives is measured by comparing the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. We review indefinite-lived intangible assets for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. Assumptions and estimates about future values and remaining useful lives of our purchased intangible assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. There were no impairment charges related to purchased intangible assets for the first six months of fiscal 2019 and 2018. Our ongoing consideration of all the factors described previously could result in additional impairment charges in the future, which could adversely affect our net income.

Income Taxes

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective tax rates differ from the statutory rate, primarily due to the tax impact of state taxes, foreign operations, R&D tax credits, domestic manufacturing deductions, foreign-derived intangible income deductions, global intangible low-taxed income, tax audit settlements, nondeductible compensation, international realignments, and transfer pricing adjustments. Our effective tax rate was 15.6% and 371.6% in the second quarter of fiscal 2019 and 2018, respectively. Our effective tax rate was 12.1% and 203.1% in the first six months of fiscal 2019 and 2018, respectively.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act significantly revises the U.S. corporate income tax by, among other things, lowering the statutory corporate income tax rate ("federal tax rate") from 35% to 21% effective January 1, 2018, implementing a modified territorial tax system, and imposing a mandatory one-time transition tax on accumulated earnings of foreign subsidiaries. As a result of the Tax Act enactment, we recorded a provisional tax expense of \$10.4 billion in fiscal 2018. In the second quarter of fiscal 2019, we completed our accounting relating to the Tax Act and recorded an additional \$58 million tax expense. The total tax charge as the result of the Tax Act is \$10.5 billion, consisting of \$8.2 billion of tax expense for the U.S. transition tax on accumulated earnings of foreign subsidiaries, \$1.2 billion of foreign withholding tax, and \$1.1 billion of tax expense for DTA re-measurement. The tax expense related to the U.S. transition tax on accumulated earnings in foreign subsidiaries is net of a \$0.9 billion benefit related to U.S. taxation of deemed foreign dividends in the transition fiscal year. This benefit may be reduced or eliminated in future legislation. If such legislation is enacted, we will record the impact of the legislation in the quarter of enactment.

Significant judgment is required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We

adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest and penalties.

Significant judgment is also required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income, and the feasibility of tax planning strategies. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Our provision for income taxes is subject to volatility and could be adversely impacted by earnings being lower than anticipated in countries that have lower tax rates and higher than anticipated in countries that have higher tax rates; by changes in the valuation of our deferred tax assets and liabilities; by changes to domestic manufacturing deduction, foreign-derived intangible income, global intangible low-tax income and base erosion and anti-abuse tax laws, regulations, or interpretations thereof; by expiration of or lapses in tax incentives; by transfer pricing adjustments, including the effect of acquisitions on our legal structure; by tax effects of nondeductible compensation; by tax costs related to intercompany realignments; by changes in accounting principles; or by changes in tax laws and regulations, treaties, or interpretations thereof, including changes to the taxation of earnings of our foreign subsidiaries, the deductibility of expenses attributable to foreign income, and the foreign tax credit rules. Significant judgment is required to determine the recognition and measurement attributes prescribed in the accounting guidance for uncertainty in income taxes. The Organisation for Economic Co-operation and Development (OECD), an international association comprised of 36 countries, including the United States, has made changes to numerous long-standing tax principles. There can be no assurance that these changes, once adopted by countries, will not have an adverse impact on our provision for income taxes. As a result of certain of our ongoing employment and capital investment actions and commitments, our income in certain countries is subject to reduced tax rates. Our failure to meet these commitments could adversely impact our provision for income taxes. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service (IRS) and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse impact on our operating results and financial condition.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Revenue

The following table presents the breakdown of revenue between product and service (in millions, except percentages):

	Three Months Ended ⁽¹⁾				Six Months Ended			
	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent
Revenue:								
Product	\$9,273	\$8,709	\$ 564	6 %	\$19,163	\$17,763	\$ 1,400	8 %
Percentage of revenue	74.5 %	73.3 %			75.1 %	73.9 %		
Service	3,173	3,178	(5)	— %	6,355	6,260	95	2 %
Percentage of revenue	25.5 %	26.7 %			24.9 %	26.1 %		
Total	\$12,446	\$11,887	\$ 559	5 %	\$25,518	\$24,023	\$ 1,495	6 %

⁽¹⁾ Total revenue, product revenue and service revenue not including the SPVSS business in the prior year period increased 7%, 9% and 1%, respectively.

We manage our business primarily on a geographic basis, organized into three geographic segments. Our revenue, which includes product and service for each segment, is summarized in the following table (in millions, except percentages):

	Three Months Ended				Six Months Ended			
	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent
Revenue:								
Americas	\$7,352	\$7,004	\$ 348	5 %	\$15,103	\$14,354	\$ 749	5 %
Percentage of revenue	59.1 %	58.9 %			59.2 %	59.7 %		
EMEA	3,223	3,062	161	5 %	6,447	5,971	476	8 %
Percentage of revenue	25.9 %	25.8 %			25.3 %	24.9 %		
APJC	1,872	1,820	52	3 %	3,968	3,698	270	7 %
Percentage of revenue	15.0 %	15.3 %			15.5 %	15.4 %		
Total	\$12,446	\$11,887	\$ 559	5 %	\$25,518	\$24,023	\$ 1,495	6 %

Amounts may not sum and percentages may not recalculate due to rounding.

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Total revenue increased by 5%. Product revenue increased by 6% while service revenue was flat. Our total revenue reflected growth across each of our geographic segments. Product revenue for the emerging countries of BRICM, in the aggregate, experienced 5% product revenue growth, with increases in Mexico, India, Brazil and Russia partially offset by a decrease in China.

In addition to the impact of macroeconomic factors, including a reduced IT spending environment and reductions in spending by government entities, revenue by segment in a particular period may be significantly impacted by several factors related to revenue recognition, including the complexity of transactions such as multiple performance obligations; the mix of financing arrangements provided to channel partners and customers; and final acceptance of the product, system, or solution, among other factors. In addition, certain customers tend to make large and sporadic purchases, and the revenue related to these transactions may also be affected by the timing of revenue recognition, which in turn would impact the revenue of the relevant segment. As has been the case in certain emerging countries from time to time, certain customers require greater levels of financing arrangements, service, and support, and these activities may occur in future periods, which may also impact the timing of the recognition of revenue.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Total revenue increased by 6%. Product revenue increased by 8% and service revenue increased by 2%. Our total revenue reflected growth across each of our geographic segments. Product revenue for the emerging countries of BRICM, in the aggregate, experienced 14% product revenue growth, with increases in Mexico, India, Russia and Brazil, partially offset by decrease in China.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Product Revenue by Segment

The following table presents the breakdown of product revenue by segment (in millions, except percentages):

	Three Months Ended					Six Months Ended				
	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent		January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent	
Product revenue:										
Americas	\$5,349	\$4,988	\$ 361	7 %		\$11,060	\$10,380	\$ 680	7 %	
Percentage of product revenue	57.7 %	57.3 %				57.7 %	58.4 %			
EMEA	2,512	2,375	137	6 %		5,039	4,614	425	9 %	
Percentage of product revenue	27.1 %	27.3 %				26.3 %	26.0 %			
APJC	1,413	1,346	67	5 %		3,064	2,769	295	11 %	
Percentage of product revenue	15.2 %	15.4 %				16.0 %	15.6 %			
Total	\$9,273	\$8,709	\$ 564	6 %		\$19,163	\$17,763	\$ 1,400	8 %	

Amounts may not sum and percentages may not recalculate due to rounding.

Americas

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Product revenue in the Americas segment increased by 7%, led by solid growth in the public sector, enterprise and commercial markets, partially offset by a decline in the service provider market. From a country perspective, product revenue increased by 7% in the United States, 35% in Mexico, 11% in Canada and 14% in Brazil.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

The increase in product revenue in the Americas segment was led by growth in the enterprise, public sector and commercial markets. These increases were partially offset by a product revenue decline in the service provider market. From a country perspective, product revenue increased by 7% in the United States, 48% in Mexico, 16% in Canada and 7% in Brazil.

EMEA

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Product revenue in the EMEA segment increased by 6%, with growth in the public sector, enterprise and commercial markets partially offset by a decline in the service provider market. Product revenue from emerging countries within EMEA was flat and product revenue for the remainder of the EMEA segment, which primarily consists of countries in Western Europe, increased by 8%.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Product revenue in the EMEA segment increased by 9%, with growth across each of the customer markets in this geographic segment. Product revenue from emerging countries within EMEA increased by 5% and product revenue for the remainder of the EMEA segment increased by 11%.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

APJC

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Product revenue in the APJC segment increased by 5%, led by solid growth in the public sector and enterprise markets and, to a lesser extent, growth in the commercial market. These increases were partially offset by a product revenue decline in the service provider market. From a country perspective, product revenue in India and in Japan each increased by 18% while product revenue in China decreased by 16%.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Product revenue in the APJC segment increased 11%, with growth across each of the customer markets in this geographic segment. From a country perspective, product revenue increased by 36% in India and 13% in Japan while product revenue in China decreased by 8%.

Product Revenue by Groups of Similar Products

In addition to the primary view on a geographic basis, we also prepare financial information related to groups of similar products and customer markets for various purposes. We report our product revenue in the following categories: Infrastructure Platforms, Applications, Security, and Other Products. This aligns our product categories with our evolving business model. Prior period amounts have been reclassified to conform to the current period's presentation.

The following table presents revenue for groups of similar products (in millions, except percentages):

	Three Months Ended			Variance in Dollars	Variance in Percent	Six Months Ended			Variance in Dollars	Variance in Percent
	January 26, 2019	January 27, 2018				January 26, 2019	January 27, 2018			
Product revenue:										
Infrastructure Platforms	\$7,128	\$ 6,710	\$ 418	6	%	\$14,770	\$13,690	\$1,080	8	%
Applications	1,465	1,184	281	24	%	2,884	2,387	497	21	%
Security	658	557	101	18	%	1,308	1,142	166	15	%
Other Products	22	258	(236)	(91)	%	200	544	(344)	(63)	%
Total	\$9,273	\$ 8,709	\$ 564	6	%	\$19,163	\$17,763	\$1,400	8	%

Amounts may not sum and percentages may not recalculate due to rounding.

Infrastructure Platforms

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

The Infrastructure Platforms product category represents our core networking offerings related to switching, routing, wireless, and the data center. Infrastructure Platforms revenue increased by 6%, or \$418 million. Switching had solid growth, with double digit revenue growth in campus switching driven by an increase in sales of our intent-based networking Catalyst 9000 Series. We also had double digit revenue growth from wireless products driven by our Wave 2 offerings as well as Meraki. Revenue from our routing products decreased due to weakness in the service provider market. Revenue from data center also decreased driven by lower sales of server products partially offset by revenue growth in our hyperconverged data center offering, HyperFlex.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Revenue from the Infrastructure Platforms product category increased 8% or \$1,080 million, with strength across the portfolio. Switching had solid growth, with solid revenue growth in campus switching driven by an increase in sales of our intent-based networking Catalyst 9000 Series, and with revenue growth in data center switching driven by increased revenue from our Nexus 9000 Series. Routing experienced revenue growth driven by growth in the service provider market. We experienced double digit revenue growth from wireless products driven by our Wave 2 offerings and Meraki. Revenue from data center increased driven by higher sales of our hyperconverged data center offering, HyperFlex, and our server products.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Applications

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

The Applications product category includes our collaboration offerings (unified communications, Cisco TelePresence and conferencing) as well as the Internet of Things (IoT) and analytics software offerings from Jasper and AppDynamics, respectively. Revenue in our Applications product category increased by 24%, or \$281 million, with growth across all of the business. We had strong revenue growth in unified communications, Telepresence and analytics from AppDynamics.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Revenue in our Applications product category increased by 21%, or \$497 million, with solid revenue growth in unified communications, TelePresence and analytics from AppDynamics.

Security

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Revenue in our Security product category increased 18%, or \$101 million, driven by higher sales of identity and access, advance threat security and unified threat management products. The acquisition of Duo Security in the first quarter of fiscal 2019 also contributed to the revenue increase in this product category.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Revenue in our Security product category increased 15%, or \$166 million, driven by higher sales of identity and access, advance threat security, unified threat management and web security products. The acquisition of Duo Security in the first quarter of fiscal 2019 also contributed to the revenue increase in this product category.

Other Products

The decrease in revenue from our Other Products category for the second quarter and first six months of fiscal 2019, compared to corresponding periods of fiscal 2018, was primarily driven by a decrease in revenue from the SPVSS business which we divested on October 28, 2018.

Service Revenue by Segment

The following table presents the breakdown of service revenue by segment (in millions, except percentages):

	Three Months Ended				Six Months Ended			
	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent
Service revenue:								
Americas	\$2,003	\$ 2,016	\$ (13)	(1)%	\$4,043	\$ 3,974	\$ 69	2 %
Percentage of service revenue	63.1 %	63.4 %			63.6 %	63.5 %		
EMEA	711	687	24	3 %	1,408	1,357	51	4 %
Percentage of service revenue	22.4 %	21.6 %			22.2 %	21.7 %		
APJC	459	475	(16)	(3)%	904	929	(25)	(3)%
Percentage of service revenue	14.5 %	15.0 %			14.2 %	14.8 %		
Total	\$3,173	\$ 3,178	\$ (5)	— %	\$6,355	\$ 6,260	\$ 95	2 %

Amounts may not sum and percentages may not recalculate due to rounding.

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Service revenue was flat. Service revenue not including the SPVSS business in the prior year period increased by 1% . The service revenue increase in the EMEA segment offset the decreases in service revenue in our APJC and Americas segments.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Service revenue increased 2%, driven by an increase in software and solution support offerings. Service revenue increased in the Americas and EMEA segments, partially offset by decreased revenue in our APJC segment.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Gross Margin

The following table presents the gross margin for products and services (in millions, except percentages):

	Three Months Ended				Six Months Ended			
	AMOUNT		PERCENTAGE		AMOUNT		PERCENTAGE	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Gross margin:								
Product	\$5,659	\$ 5,355	61.0 %	61.5 %	\$11,750	\$ 10,794	61.3 %	60.8 %
Service	2,114	2,143	66.6 %	67.4 %	4,169	4,131	65.6 %	66.0 %
Total	\$7,773	\$ 7,498	62.5 %	63.1 %	\$15,919	\$ 14,925	62.4 %	62.1 %

Product Gross Margin

The following table summarizes the key factors that contributed to the change in product gross margin percentage for the second quarter and first six months of fiscal 2019, as compared with the corresponding prior year periods:

	Product	
	Gross Margin	
	Percentage	
	Three Months Ended	Six Months Ended
Fiscal 2018	61.5 %	60.8 %
Product pricing	(1.0)%	(1.5)%
Mix of products sold	0.3 %	(0.2)%
Productivity ⁽¹⁾	(0.2)%	1.1 %
Legal and indemnification settlements	(0.1)%	0.7 %
Impact from divestiture of SPVSS business	0.5 %	0.5 %
Other	— %	(0.1)%
Fiscal 2019	61.0 %	61.3 %

⁽¹⁾ Productivity includes overall manufacturing-related costs, such as component costs, warranty expense, provision for inventory, freight, logistics, shipment volume, and other items not categorized elsewhere.

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Product gross margin decreased by 0.5 percentage points driven by unfavorable impacts from product pricing and productivity, partially offset by favorable product mix. Our product gross margin also benefited from the sale of our lower margin SPVSS business during the second quarter of fiscal 2019.

The negative pricing impact, which was lower than the year-over-year impact we experienced in the second quarter of fiscal 2018, was driven by typical market factors and impacted each of our geographic segments and customer markets. Our productivity was negatively impacted by higher costs of memory and other components, partially offset by cost reductions including value engineering efforts (e.g. component redesign, board configuration, test processes and transformation processes) and continued operational efficiency in manufacturing operations.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Product gross margin increased by 0.5 percentage points driven by productivity improvements, partially offset by unfavorable impacts from product pricing and product mix. A charge of \$127 million to product cost of sales recorded in the first six months of fiscal 2018 related to legal and indemnification settlements also contributed to the increase. Our product gross margin also benefited from the sale of our lower margin SPVSS business during the second quarter of fiscal 2019.

Productivity improvements were driven by cost reductions including value engineering efforts (e.g. component redesign, board configuration, test processes, and transformation processes) and continued operational efficiency in

manufacturing operations.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Service Gross Margin

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Our service gross margin percentage decreased by 0.8 percentage points due to increased headcount-related costs and increased delivery costs, partially offset by favorable mix.

Our service gross margin normally experiences some fluctuations due to various factors such as the timing of contract initiations and renewals, our strategic investments in headcount, and the resources we deploy to support the overall service business. Another factor is the mix of service offerings, as the gross margin from our advanced services is typically lower than the gross margin from technical support services.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Service gross margin percentage decreased by 0.4 percentage points due to increased headcount-related costs and increased delivery costs. These cost impacts were partially offset by the resulting benefit to gross margin of higher sales volume.

Gross Margin by Segment

The following table presents the total gross margin for each segment (in millions, except percentages):

	Three Months Ended			Six Months Ended					
	AMOUNT		PERCENTAGE	AMOUNT		PERCENTAGE			
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2019	January 27, 2018	January 26, 2019	January 27, 2019	January 26, 2019	January 27, 2018
Gross margin:									
Americas	\$4,796	\$ 4,614	65.2 %	65.9 %	%	\$9,866	\$ 9,336	65.3 %	65.0 %
EMEA	2,070	1,977	64.2 %	64.6 %	%	4,141	3,816	64.2 %	63.9 %
APJC	1,109	1,094	59.2 %	60.1 %	%	2,309	2,259	58.2 %	61.1 %
Segment total	7,975	7,685	64.1 %	64.7 %	%	16,316	15,411	63.9 %	64.2 %
Unallocated corporate items ⁽¹⁾	(202)	(187)				(397)	(486)		
Total	\$7,773	\$ 7,498	62.5 %	63.1 %	%	\$15,919	\$ 14,925	62.4 %	62.1 %

⁽¹⁾ The unallocated corporate items include the effects of amortization and impairments of acquisition-related intangible assets, share-based compensation expense, significant litigation settlements and other contingencies, charges related to asset impairments and restructurings, and certain other charges. We do not allocate these items to the gross margin for each segment because management does not include such information in measuring the performance of the operating segments.

Amounts may not sum and percentages may not recalculate due to rounding.

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

We experienced a gross margin percentage decrease in our Americas segment due to unfavorable impacts from pricing and mix, partially offset by productivity improvements.

The gross margin percentage decrease in our EMEA segment was due primarily to lower service gross margin.

Product gross margin in this segment increased due to favorable product mix partially offset by negative impacts from productivity and pricing.

The APJC segment gross margin percentage decrease was due primarily to lower service gross margin. Product gross margin in this segment increased slightly due to favorable product mix and productivity improvements, partially offset by negative impacts from pricing.

The gross margin percentage for a particular segment may fluctuate, and period-to-period changes in such percentages may or may not be indicative of a trend for that segment.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

The Americas segment had a gross margin percentage increase driven by productivity improvements, partially offset by unfavorable impacts from pricing and mix.

The gross margin percentage increase in our EMEA segment was due to productivity improvements and favorable mix, partially offset by negative impacts from pricing.

The APJC segment gross margin percentage decrease was due to negative impacts from pricing partially offset by favorable mix and productivity improvements.

Research and Development ("R&D"), Sales and Marketing, and General and Administrative ("G&A") Expenses
R&D, sales and marketing, and G&A expenses are summarized in the following table (in millions, except percentages):

	Three Months Ended				Six Months Ended			
	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent	January 26, 2019	January 27, 2018	Variance in Dollars	Variance in Percent
Research and development	\$ 1,557	\$ 1,549	\$ 8	1 %	\$ 3,165	\$ 3,116	\$ 49	2 %
Percentage of revenue	12.5 %	13.0 %			12.4 %	13.0 %		
Sales and marketing	2,271	2,235	36	2 %	4,681	4,569	112	2 %
Percentage of revenue	18.2 %	18.8 %			18.3 %	19.0 %		
General and administrative	509	483	26	5 %	720	1,040	(320)	(31)%
Percentage of revenue	4.1 %	4.1 %			2.8 %	4.3 %		
Total	\$ 4,337	\$ 4,267	\$ 70	2 %	\$ 8,566	\$ 8,725	\$ (159)	(2)%
Percentage of revenue	34.8 %	35.9 %			33.6 %	36.3 %		

R&D Expenses

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

R&D expenses increased slightly as increases in headcount-related expenses and acquisition-related/divestiture costs significantly offset the decrease in discretionary spending.

We continue to invest in R&D in order to bring a broad range of products to market in a timely fashion. If we believe that we are unable to enter a particular market in a timely manner with internally developed products, we may purchase or license technology from other businesses, or we may partner with or acquire businesses as an alternative to internal R&D.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

R&D expenses increased primarily due to higher headcount-related expenses and, to a lesser extent, higher contracted services and higher acquisition-related/divestiture costs. These increases were partially offset by lower discretionary spending and share-based compensation expense.

Sales and Marketing Expenses

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Sales and marketing expenses increased due to higher discretionary spending, headcount-related expenses, contracted services and acquisition-related/divestiture costs, partially offset by lower share-based compensation expense.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Sales and marketing expenses increased due to higher discretionary spending, higher headcount-related expenses and, to a lesser extent, higher contracted services and higher acquisition-related/divestiture costs, partially offset by lower share-based compensation expense.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

G&A Expenses

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

G&A expenses increased due to higher discretionary spending and headcount-related expenses, partially offset by lower contracted services.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

G&A expenses decreased due to a benefit from the \$400 million litigation settlement with Arista, partially offset by higher discretionary spending, higher acquisition-related/divestiture costs and higher headcount-related expenses.

Effect of Foreign Currency

In the second quarter of fiscal 2019, foreign currency fluctuations, net of hedging, decreased the combined R&D, sales and marketing, and G&A expenses by approximately \$52 million, or 1.2%, compared with the second quarter of fiscal 2018.

In the first six months of fiscal 2019, foreign currency fluctuations, net of hedging, decreased the combined R&D, sales and marketing, and G&A expenses by approximately \$102 million, or 1.2%, compared with the first six months of fiscal 2018.

Share-Based Compensation Expense

The following table presents share-based compensation expense (in millions):

	Three Months Ended January 26, 2019		Six Months Ended January 27, 2019	
	2019	2018	2019	2018
Cost of sales—product	\$22	\$ 23	\$45	\$ 46
Cost of sales—service	31	31	64	65
Share-based compensation expense in cost of sales	53	54	109	111
Research and development	133	134	263	270
Sales and marketing	125	135	262	270
General and administrative	65	64	127	128
Restructuring and other charges	19	12	42	18
Share-based compensation expense in operating expenses	342	345	694	686
Total share-based compensation expense	\$395	\$ 399	\$803	\$ 797

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

The decrease in share-based compensation expense was due primarily to higher forfeitures partially offset by higher restructuring charges.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

The increase in share-based compensation expense was due primarily to higher restructuring charges.

Amortization of Purchased Intangible Assets

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

	Three Months Ended January 26, 2019		Six Months Ended January 27, 2019	
	2019	2018	2019	2018
Amortization of purchased intangible assets:				
Cost of sales	\$156	\$ 160	\$307	\$ 314
Operating expenses	39	60	73	121
Total	\$195	\$ 220	\$380	\$ 435

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Amortization of purchased intangible assets decreased due largely to the purchased intangible assets related to the divestiture of SPVSS business on October 28, 2018, partially offset by amortization from our recent acquisitions.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Amortization of purchased intangible assets decreased due largely to the purchased intangible assets related to the divestiture of SPVSS business on October 28, 2018, partially offset by amortization from our recent acquisitions.

Restructuring and Other Charges

We initiated a restructuring plan during fiscal 2018 in order to realign our organization and enable further investment in key priority areas, with estimated pretax charges of approximately \$600 million. In connection with this restructuring plan, we incurred charges of \$186 million and \$264 million for the second quarter and first six months of fiscal 2019, respectively, and have incurred cumulative charges of \$372 million since inception. We expect this restructuring plan to be substantially completed in fiscal 2019.

We incurred restructuring and other charges of \$98 million and \$250 million for the second quarter and first six months of fiscal 2018 in connection with the restructuring plan announced in August 2016.

These charges were primarily cash-based and consisted of employee severance and other one-time termination benefits, and other associated costs. We expect to reinvest substantially all of the cost savings from these restructuring actions in our key priority areas. As a result, the overall cost savings from these restructuring actions are not expected to be material for future periods.

Operating Income

The following table presents our operating income and our operating income as a percentage of revenue (in millions, except percentages):

	Three Months Ended		Six Months Ended	
	January 26, 2019	January 27, 2018	January 26, 2019	January 27, 2018
Operating income	\$3,211	\$ 3,073	\$7,016	\$ 5,829
Operating income as a percentage of revenue	25.8 %	25.9 %	27.5 %	24.3 %

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

Operating income increased by 4% and as a percentage of revenue operating income decreased by 0.1 percentage points. These changes resulted primarily from: a revenue increase, a gross margin percentage decrease (driven primarily by unfavorable impacts from pricing and productivity), and higher restructuring and other charges.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

Operating income increased by 20% and as a percentage of revenue operating income increased by 3.2 percentage points. These increases resulted primarily from: a revenue increase, a gross margin percentage increase (driven primarily by productivity improvements and a charge of \$127 million to product cost of sales recorded in the first six months of fiscal 2018 related to legal and indemnification settlements) and a benefit from the \$400 million litigation settlement with Arista in the first quarter of fiscal 2019.

Interest and Other Income (Loss), Net

Interest Income (Expense), Net The following table summarizes interest income and interest expense (in millions):

	Three Months Ended			Six Months Ended		
	January 26, 2019	January 27, 2018	Variance in Dollars	January 26, 2019	January 27, 2018	Variance in Dollars
Interest income	\$328	\$ 396	\$ (68)	\$672	\$ 775	\$ (103)
Interest expense	(223)	(247)	24	(444)	(482)	38
Interest income (expense), net	\$105	\$ 149	\$ (44)	\$228	\$ 293	\$ (65)

Interest income decreased, driven by a decrease in the average balance of cash and available-for-sale debt investments. The decrease in interest expense was driven by a lower average debt balance, partially offset by the impact of higher effective interest rates.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Income (Loss), Net The components of other income (loss), net, are summarized as follows (in millions):

	Three Months Ended			Six Months Ended		
	January 26, 2019	January 27, 2018	Variance in Dollars	January 26, 2019	January 27, 2018	Variance in Dollars
Gains (losses) on investments, net:						
Available-for-sale debt investments	\$(5)	\$(96)	\$ 91	\$(11)	\$(92)	\$ 81
Marketable equity investments	61	154	(93)	57	183	(126)
Non-marketable equity and other investments	(3)	2	(5)	1	37	(36)
Net gains (losses) on investments	53	60	(7)	47	128	(81)
Other gains (losses), net	(26)	(50)	24	(39)	(56)	17
Other income (loss), net	\$27	\$ 10	\$ 17	\$8	\$ 72	\$ (64)

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

The total change in net gains (losses) on available-for-sale debt investments was primarily attributable to lower realized losses as a result of market conditions, and the timing of sales of these investments.

The total change in net gains (losses) on marketable equity investments was attributable to market value fluctuations and the timing of recognition of gains and losses.

The change in net gains (losses) on non-marketable equity and other investments was primarily due to higher realized net losses, partially offset by higher unrealized gains and lower impairment charges.

The change in other gains (losses), net was primarily driven by net favorable foreign exchange impacts.

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

The total change in net gains (losses) on available-for-sale debt investments was primarily attributable to lower realized losses as a result of market conditions, and the timing of sales of these investments.

The total change in net gains (losses) on marketable equity investments was attributable to market value fluctuations and the timing of recognition of gains and losses.

The change in net gains (losses) on non-marketable equity and other investments was primarily due to higher realized net losses, partially offset by higher unrealized gains and lower impairment charges.

The change in other gains (losses), net was driven by net favorable foreign exchange impacts partially offset by lower gains from customer lease terminations.

Provision for Income Taxes

Three Months Ended January 26, 2019 Compared with Three Months Ended January 27, 2018

The provision for income taxes resulted in an effective tax rate of 15.6% for the second quarter of fiscal 2019 compared with 371.6% for the second quarter of fiscal 2018. The decrease in the effective tax rate was primarily due to the one-time transition tax on accumulated earnings of foreign subsidiaries, foreign withholding tax, and DTA re-measurement recorded during the second quarter of fiscal 2018.

Our effective tax rate will increase or decrease based upon the tax effect of the difference between the share-based compensation expenses and the benefits taken on the company's tax returns. We recognize excess tax benefits on a discrete basis and therefore anticipate the effective tax rate to vary from quarter to quarter depending on our share price in each period.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Six Months Ended January 26, 2019 Compared with Six Months Ended January 27, 2018

The provision for income taxes resulted in an effective tax rate of 12.1% for the first six months of fiscal 2019 compared with 203.1% for the first six months of fiscal 2018. The decrease in the effective tax rate was primarily due to the one-time transition tax on accumulated earnings of foreign subsidiaries, foreign withholding tax, and DTA re-measurement recorded during the first six months of fiscal 2018.

LIQUIDITY AND CAPITAL RESOURCES

The following sections discuss the effects of changes in our balance sheet, our capital allocation strategy including stock repurchase program and dividends, our contractual obligations, and certain other commitments and activities on our liquidity and capital resources.

Balance Sheet and Cash Flows

Cash and Cash Equivalents and Investments The following table summarizes our cash and cash equivalents and investments (in millions):

	January 26, 2019	July 28, 2018	Increase (Decrease)
Cash and cash equivalents	\$ 9,835	\$8,934	\$ 901
Available-for-sale debt investments	30,486	37,009	(6,523)
Marketable equity securities	62	605	(543)
Total	\$ 40,383	\$46,548	\$ (6,165)

The decrease in cash and cash equivalents and investments in the first six months of fiscal 2019 was primarily driven by cash returned to shareholders in the form of repurchases of common stock of \$10.1 billion under the stock repurchase program and cash dividends of \$3.0 billion; net cash paid for acquisitions and divestitures of \$1.6 billion; and capital expenditures of \$0.5 billion. These uses of cash were partially offset by cash provided by operating activities of \$7.6 billion and timing of settlements of investments and other of \$1.6 billion.

In addition to cash requirements in the normal course of business, in the third quarter of fiscal 2019 on February 6, 2019, we closed the acquisition of Luxtera for a purchase price of approximately \$0.7 billion in cash and assumed equity awards. Also approximately \$0.7 billion of the U.S. transition tax on accumulated earnings for foreign subsidiaries is payable in less than one year. Additionally, \$9.7 billion of long term debt which was outstanding at January 26, 2019 (of which \$2.0 billion was repaid on February 15, 2019) and approximately \$2 billion of commercial paper notes (issued in February 2019) will mature within the next 12 months from the balance sheet date. See further discussion of liquidity under "Liquidity and Capital Resource Requirements" below.

We maintain an investment portfolio of various holdings, types, and maturities. We classify our investments as short-term investments based on their nature and their availability for use in current operations. We believe the overall credit quality of our portfolio is strong, with our cash equivalents and our available-for-sale debt investment portfolio consisting primarily of high quality investment-grade securities. We believe that our strong cash and cash equivalents and investments position allows us to use our cash resources for strategic investments to gain access to new technologies, for acquisitions, for customer financing activities, for working capital needs, and for the repurchase of shares of common stock and payment of dividends as discussed below.

Free Cash Flow and Capital Allocation As part of our capital allocation strategy, we intend to return a minimum of 50% of our free cash flow annually to our shareholders through cash dividends and repurchases of common stock. We define free cash flow as net cash provided by operating activities less cash used to acquire property and equipment. The following table reconciles our net cash provided by operating activities to free cash flow (in millions):

	Six Months Ended January 26, 2019	Six Months Ended January 27, 2018
Net cash provided by operating activities	\$7,560	\$ 7,150

Acquisition of property and equipment	(473)	(379)
Free cash flow	\$7,087	\$ 6,771

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors, including fluctuations in our operating results, the rate at which products are shipped during the quarter (which we refer to as shipment linearity), the timing and collection of accounts receivable and financing receivables, inventory and supply chain management, deferred revenue, and the timing and amount of tax and other payments. For additional discussion, see "Part II, Item 1A. Risk Factors" in this report.

We consider free cash flow to be a liquidity measure that provides useful information to management and investors because of our intent to return a stated percentage of free cash flow to shareholders in the form of dividends and stock repurchases. We further regard free cash flow as a useful measure because it reflects cash that can be used to, among other things, invest in our business, make strategic acquisitions, repurchase common stock, and pay dividends on our common stock, after deducting capital investments. A limitation of the utility of free cash flow as a measure of financial performance and liquidity is that the free cash flow does not represent the total increase or decrease in our cash balance for the period. In addition, we have other required uses of cash, including repaying the principal of our outstanding indebtedness. Free cash flow is not a measure calculated in accordance with U.S. generally accepted accounting principles and should not be regarded in isolation or as an alternative for net income provided by operating activities or any other measure calculated in accordance with such principles, and other companies may calculate free cash flow in a different manner than we do.

The following table summarizes the dividends paid and stock repurchases (in millions, except per-share amounts):

Quarter Ended	DIVIDENDS		STOCK REPURCHASE PROGRAM			
	Per Share	Amount	Shares	Weighted-Average Price per Share	Amount	TOTAL
Fiscal 2019						
January 26, 2019	\$0.33	\$ 1,470	111	\$ 45.09	\$ 5,016	\$ 6,486
October 27, 2018	\$0.33	\$ 1,500	109	\$ 46.01	\$ 5,026	\$ 6,526
Fiscal 2018						
July 28, 2018	\$0.33	\$ 1,535	138	\$ 43.58	\$ 6,015	\$ 7,550
April 28, 2018	\$0.33	\$ 1,572	140	\$ 42.83	\$ 6,015	\$ 7,587
January 27, 2018	\$0.29	\$ 1,425	103	\$ 39.07	\$ 4,011	\$ 5,436
October 28, 2017	\$0.29	\$ 1,436	51	\$ 31.80	\$ 1,620	\$ 3,056

On February 13, 2019, our Board of Directors declared a quarterly dividend of \$0.35 per common share to be paid on April 24, 2019 to all shareholders of record as of the close of business on April 5, 2019. Any future dividends are subject to the approval of our Board of Directors.

On February 13, 2019, our Board of Directors authorized a \$15 billion increase to the stock repurchase program. The remaining authorized amount for stock repurchases under this program, including the additional authorization, is approximately \$24 billion, with no termination date.

The purchase price for the shares of our stock repurchased is reflected as a reduction to shareholders' equity. We are required to allocate the purchase price of the repurchased shares as (i) a reduction to retained earnings and (ii) a reduction of common stock and additional paid-in capital. As a result of future stock repurchases, we may report an accumulated deficit in future periods in shareholders' equity.

Accounts Receivable, Net The following table summarizes our accounts receivable, net (in millions):

	January 26, 2019	July 28, 2018	Increase (Decrease)
Accounts receivable, net	\$ 3,745	\$ 5,554	\$ (1,809)

Our accounts receivable net, as of January 26, 2019 decreased by approximately 33%, as compared with the end of fiscal 2018, primarily due to product and service billings being more linear in the second quarter of fiscal 2019 compared with the fourth quarter of fiscal 2018.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Inventory Supply Chain The following table summarizes our inventories and purchase commitments with contract manufacturers and suppliers (in millions):

	January 26, 2019	July 28, 2018	Increase (Decrease)
Inventories	\$ 1,701	\$ 1,846	\$ (145)

Inventory as of January 26, 2019 decreased by 8% from our inventory balance at the end of fiscal 2018. The decrease in inventory was due primarily to lower deferred cost of sales related to the adoption of ASC 606 in the beginning of our first quarter of fiscal 2019.

We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to manage manufacturing lead times and help ensure adequate component supply, we enter into agreements with contract manufacturers and suppliers that allow them to procure inventory based upon criteria as defined by us or that establish the parameters defining our requirements and our commitment to securing manufacturing capacity.

Our purchase commitments are for short-term product manufacturing requirements as well as for commitments to suppliers to secure manufacturing capacity. Certain of our purchase commitments with contract manufacturers and suppliers relate to arrangements to secure long-term pricing for certain product components for multi-year periods. A significant portion of our reported purchase commitments arising from these agreements are firm, noncancelable, and unconditional commitments. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. We believe our inventory and purchase commitments levels are in line with our current demand forecasts. The following table summarizes our purchase commitments with contract manufacturers and suppliers as of the respective period ends (in millions):

Commitments by Period	January 26, 2019	July 28, 2018
Less than 1 year	\$ 5,366	\$ 5,407
1 to 3 years	731	710
3 to 5 years	180	360
Total	\$ 6,277	\$ 6,477

Purchase commitments with contract manufacturers and suppliers decreased 3% compared to the end of fiscal 2018. On a combined basis, inventories and purchase commitments with contract manufacturers and suppliers decreased by 4% compared with the end of fiscal 2018.

Inventory and supply chain management remain areas of focus as we balance the need to maintain supply chain flexibility to help ensure competitive lead times with the risk of inventory obsolescence because of rapidly changing technology and customer requirements. We believe the amount of our inventory and purchase commitments is appropriate for our revenue levels.

Financing Receivables and Guarantees The following table summarizes our financing receivables (in millions):

	January 26, 2019	July 28, 2018	Increase (Decrease)
Lease receivables, net	\$ 2,371	\$ 2,576	\$ (205)
Loan receivables, net	4,862	4,939	(77)
Financed service contracts, net	2,389	2,316	73
Total, net	\$ 9,622	\$ 9,831	\$ (209)

Financing Receivables Our financing arrangements include leases, loans, and financed service contracts. Lease receivables include sales-type and direct-financing leases. Arrangements related to leases are generally collateralized by a security interest in the underlying assets. Our loan receivables include customer financing for purchases of our hardware, software and services and also may include additional funds for other costs associated with network installation and integration of our products and services. We also provide financing to certain qualified customers for

long-term service contracts, which primarily relate to technical support services. The majority of the revenue from these financed service contracts is deferred and is recognized ratably over the period during which the services are performed. Financing receivables decreased by 2%. We expect to continue to expand the use of our financing programs in the near term.

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CISCO SYSTEMS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Financing Guarantees In the normal course of business, third parties may provide financing arrangements to our customers and channel partners under financing programs. The financing arrangements to customers provided by third parties are related to leases and loans and typically have terms of up to three years. In some cases, we provide guarantees to third parties for these lease and loan arrangements. The financing arrangements to channel partners consist of revolving short-term financing provided by third parties, generally with payment terms ranging from 60 to 90 days. In certain instances, these financing arrangements result in a transfer of our receivables to the third party. The receivables are derecognized upon transfer, as these transfers qualify as true sales, and we receive payments for the receivables from the third party based on our standard payment terms.

The volume of channel partner financing was \$14.5 billion and \$13.6 billion for the first six months of fiscal 2019 and 2018, respectively. These financing arrangements facilitate the working capital requirements of the channel partners, and in some cases, we guarantee a portion of these arrangements. The balance of the channel partner financing subject to guarantees was \$1.3 billion and \$1.0 billion as of January 26, 2019 and July 28, 2018, respectively. We could be called upon to make payments under these guarantees in the event of nonpayment by the channel partners or end-user customers. Historically, our payments under these arrangements have been immaterial. Where we provide a guarantee, we defer the revenue associated with the channel partner and end-user financing arrangement in accordance with revenue recognition policies, or we record a liability for the fair value of the guarantees. In either case, the deferred revenue is recognized as revenue when the guarantee is removed. As of January 26, 2019, the total maximum potential future payments related to these guarantees was approximately \$363 million, of which approximately \$86 million was recorded as deferred revenue.

Borrowings

Senior Notes The following table summarizes the principal amount of our senior notes (in millions):

	Maturity Date	January 26, 2019	July 28, 2018
Senior notes:			
Floating-rate notes:			
Three-month LIBOR plus 0.50%	March 1, 2019	\$ 500	\$ 500
Three-month LIBOR plus 0.34%	September 20, 2019	500	500
Fixed-rate notes:			
4.95%	February 15, 2019	2,000	2,000
1.60%	February 28, 2019	1,000	1,000
2.125%	March 1, 2019	1,750	1,750
1.40%	September 20, 2019	1,500	1,500
4.45%	January 15, 2020	2,500	2,500
2.45%	June 15, 2020	1,500	1,500
2.20%	February 28, 2021	2,500	2,500
2.90%	March 4, 2021	500	500
1.85%		2,000	2,000

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	September 20, 2021		
3.00%	June 15, 2022	500	500
2.60%	February 28, 2023	500	500
2.20%			