CISCO SYSTEMS INC
Form 10-Q
November 22, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended October 29, 2011

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 incorporation or organization)	**(I.R.S. Employer Identification Number)**

170 West Tasman Drive

San Jose, California 95134

(Address of principal executive office and zip code)

(408) 526-4000

(Registrant s telephone number, including area code)

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

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

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

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

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

Number of shares of the registrant s common stock outstanding as of November 15, 2011: 5,375,863,983

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Cisco Systems, Inc.

FORM 10-Q for the Quarter Ended October 29, 2011

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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)

	October 29, 2011	July 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,747	$ 7,662
Investments	39,641	36,923
Accounts receivable, net of allowance for doubtful accounts of $180 at October 29, 2011 and $204 at July 30, 2011	4,300	4,698
Inventories	1,622	1,486
Financing receivables, net	3,300	3,111
Deferred tax assets	2,158	2,410
Other current assets	1,499	941
Total current assets	57,267	57,231
Property and equipment, net	3,753	3,916
Financing receivables, net	3,209	3,488
Goodwill	16,823	16,818
Purchased intangible assets, net	2,369	2,541
Other assets	3,543	3,101
TOTAL ASSETS	$ 86,964	$ 87,095
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	$ 589	$ 588
Accounts payable	908	876
Income taxes payable	455	120
Accrued compensation	2,557	3,163
Deferred revenue	8,444	8,025
Other current liabilities	4,508	4,734
Total current liabilities	17,461	17,506
Long-term debt	16,264	16,234
Income taxes payable	1,501	1,191
Deferred revenue	3,952	4,182
Other long-term liabilities	572	723

Total liabilities	39,750	39,836
Commitments and contingencies (Note 12)		
Equity:		
Cisco shareholders equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding		
Common stock and additional paid-in capital, $0.001 par value: 20,000 shares authorized; 5,371 and 5,435 shares issued and outstanding at October 29, 2011 and July 30, 2011, respectively	38,297	38,648
Retained earnings	7,910	7,284
Accumulated other comprehensive income	981	1,294
Total Cisco shareholders equity	47,188	47,226
Noncontrolling interests	26	33
Total equity	47,214	47,259
TOTAL LIABILITIES AND EQUITY	$86,964	$ 87,095

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	
	October 29, 2011	**October 30, 2010**
NET SALES:		
Product	$ 8,952	$ 8,700
Service	2,304	2,050
Total net sales	11,256	10,750
COST OF SALES:		
Product	3,563	3,249
Service	803	746
Total cost of sales	4,366	3,995
GROSS MARGIN	6,890	6,755
OPERATING EXPENSES:		
Research and development	1,375	1,431
Sales and marketing	2,452	2,402
General and administrative	552	458
Amortization of purchased intangible assets	99	113
Restructuring and other charges	202	
Total operating expenses	4,680	4,404
OPERATING INCOME	2,210	2,351
Interest income	164	160
Interest expense	(148)	(166)
Other income, net	19	80
Interest and other income, net	35	74
INCOME BEFORE PROVISION FOR INCOME TAXES	2,245	2,425
Provision for income taxes	468	495
NET INCOME	$ 1,777	$ 1,930
Net income per share:		
Basic	$ 0.33	$ 0.34
Diluted	$ 0.33	$ 0.34

Shares used in per-share calculation:		
Basic	5,394	5,595
Diluted	5,407	5,675
Cash dividends declared per common share	$ 0.06	$

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Three Months Ended October 29, 2011	Three Months Ended October 30, 2010
Cash flows from operating activities:		
Net income	$ 1,777	$ 1,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and other	621	553
Share-based compensation expense	341	407
Provision for doubtful accounts	(22)	(22)
Deferred income taxes	109	338
Excess tax benefits from share-based compensation	(21)	(28)
Net gains on investments	(13)	(108)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	399	506
Inventories	(168)	(193)
Financing receivables, net		(78)
Other assets	(374)	(30)
Accounts payable	36	45
Income taxes, net	(38)	(408)
Accrued compensation	(548)	(678)
Deferred revenue	232	(367)
Other liabilities	2	(200)
Net cash provided by operating activities	2,333	1,667
Cash flows from investing activities:		
Purchases of investments	(11,770)	(9,569)
Proceeds from sales of investments	7,721	6,232
Proceeds from maturities of investments	1,179	3,574
Acquisition of property and equipment	(265)	(326)
Acquisition of businesses, net of cash and cash equivalents acquired	(38)	(69)
Change in investments in privately held companies	(95)	(28)
Other	77	19
Net cash used in investing activities	(3,191)	(167)
Cash flows from financing activities:		
Issuances of common stock	203	374
Repurchases of common stock	(1,881)	(2,701)
Short-term borrowings, maturities less than 90 days, net		(16)
Excess tax benefits from share-based compensation	21	28
Dividends paid	(322)	
Other	(78)	30
Net cash used in financing activities	(2,057)	(2,285)

Net decrease in cash and cash equivalents	(2,915)	(785)
Cash and cash equivalents, beginning of period	7,662	4,581
Cash and cash equivalents, end of period	$ 4,747	$ 3,796
Cash paid for:		
Interest	$ 220	$ 270
Income taxes	$ 398	$ 565

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(in millions)

(Unaudited)

Three Months Ended October 29, 2011	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders Equity	Noncontrolling Interests	Total Equity
BALANCE AT JULY 30, 2011	5,435	$ 38,648	$ 7,284	$ 1,294	$ 47,226	$ 33	$ 47,259
Net income			1,777		1,777		1,777
Change in:							
Unrealized gains and losses on investments				(52)	(52)	(7)	(59)
Derivative instruments				(50)	(50)		(50)
Cumulative translation adjustment and other				(211)	(211)		(211)
Comprehensive income (loss)					1,464	(7)	1,457
Issuance of common stock	45	203			203		203
Repurchase of common stock	(109)	(852)	(829)		(1,681)		(1,681)
Cash dividends declared			(322)		(322)		(322)
Tax effects from employee stock incentive plans		(43)			(43)		(43)
Share-based compensation expense		341			341		341
BALANCE AT OCTOBER 29, 2011	5,371	$ 38,297	$ 7,910	$ 981	$ 47,188	$ 26	$ 47,214

Three Months Ended October 30, 2010	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders Equity	Noncontrolling Interests	Total Equity
BALANCE AT JULY 31, 2010	5,655	$ 37,793	$ 5,851	$ 623	$ 44,267	$ 18	$ 44,285
Net income			1,930		1,930		1,930
Change in:							
Unrealized gains and losses on investments				40	40	2	42
Derivative instruments				49	49		49
Cumulative translation adjustment and other				238	238		238
Comprehensive income					2,257	2	2,259
Issuance of common stock	41	374			374		374
Repurchase of common stock	(119)	(880)	(1,747)		(2,627)		(2,627)
Tax effects from employee stock incentive plans		(9)			(9)		(9)
Purchase acquisitions		6			6		6
Share-based compensation expense		407			407		407
BALANCE AT OCTOBER 30, 2010	5,577	$ 37,691	$ 6,034	$ 950	$ 44,675	$ 20	$ 44,695

In September 2001, the Company s Board of Directors authorized a stock repurchase program. As of October 29, 2011, the Company s Board of Directors had authorized an aggregate repurchase of up to $82 billion of common stock under this program with no termination date. For additional information regarding stock repurchases, see Note 13 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impact on Cisco shareholders equity are summarized in the following table (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Total Cisco Shareholders Equity
Repurchases of common stock under the repurchase program	3,578	$ 15,866	$ 57,451	$ 73,317

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 or Cisco) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2012 and fiscal 2011 are each 52-week fiscal years. The Consolidated Financial Statements include the accounts of Cisco and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. The Company conducts business globally and is primarily managed on a geographic basis. Beginning in fiscal 2012, the Company is organized into the following three geographic segments: the Americas; Europe, Middle East, and Africa (EMEA); and Asia Pacific, Japan, and China (APJC). In fiscal 2011, the Company was organized into four geographic segments, which consisted of United States and Canada, European Markets, Emerging Markets, and Asia Pacific Markets. As a result of this geographic segment change in fiscal 2012, countries within the former Emerging Markets segment were consolidated into either EMEA or the Americas segment depending on their respective geographic locations. The Company has reclassified the geographic segment data for the prior period to conform to the current period s presentation.

The accompanying financial data as of October 29, 2011 and for the three months ended October 29, 2011 and October 30, 2010 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. The July 30, 2011 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended July 30, 2011.

The Company consolidates its investment in a venture fund managed by SOFTBANK Corp. and its affiliates (SOFTBANK) as the Company is the primary beneficiary. The noncontrolling interests attributed to SOFTBANK are presented as a separate component from the Company s equity in the equity section of the Consolidated Balance Sheets. SOFTBANK s share of the earnings in the venture fund is not presented separately in the Consolidated Statements of Operations and is included in other income, net, as this amount is not material for any of the fiscal periods presented.

In the opinion of management, all adjustments (which include normal recurring adjustments, except as disclosed herein) necessary to present fairly the statement of financial position as of October 29, 2011 and results of operations, cash flows, and equity for the three months ended October 29, 2011 and October 30, 2010, as applicable, have been made. The results of operations for the three months ended October 29, 2011 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

In addition to the geographic segment change referred to above, certain other reclassifications have been made to prior period amounts in order to conform to the current period s presentation.

The Company has evaluated subsequent events through the date that the financial statements were issued.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Summary of Significant Accounting Policies

Recent Accounting Standards or Updates Not Yet Effective

In May 2011, the Financial Accounting Standards Board (FASB) issued an accounting standard update to provide guidance on achieving a consistent definition of and common requirements for measurement of and disclosure concerning fair value as between U.S. GAAP and International Financial Reporting Standards. This accounting standard update is effective for the Company beginning in the third quarter of fiscal 2012. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements but does not expect it will have a material impact.

In June 2011, the FASB issued an accounting standard update to provide guidance on increasing the prominence of items reported in other comprehensive income. This accounting standard update eliminates the option to present components of other comprehensive income as part of the statement of equity and requires that the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This accounting standard update is effective for the Company beginning in the first quarter of fiscal 2013.

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

3. Business Combinations

The Company completed two business combinations during the three months ended October 29, 2011. A summary of the allocation of the total purchase consideration is presented as follows (in millions):

	Shares Issued	Purchase Consideration	Net Liabilities Assumed	Purchased Intangible Assets	Goodwill
Total acquisitions		$ 38	$ (2)	$ 19	$ 21

The total purchase consideration related to the Company s business combinations completed during the three months ended October 29, 2011 consisted of either cash consideration or cash consideration along with vested share-based awards assumed. Total transaction costs related to business combination activities for the three months ended October 29, 2011 and October 30, 2010 were $2 million and $8 million, respectively, which were expensed as incurred and recorded as G&A expenses.

The Company continues to evaluate certain assets and liabilities related to business combinations completed during the recent periods. Additional information, which existed as of the acquisition date but was at that time unknown to the Company, may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Changes to amounts recorded as assets or liabilities may result in a corresponding adjustment to goodwill.

The goodwill generated from the Company s business combinations completed during the three months ended October 29, 2011 is primarily related to expected synergies. The goodwill is not deductible for U.S. federal income tax purposes.

The Consolidated Financial Statements include the operating results of each business combination from the date of acquisition. Pro forma results of operations for the acquisitions completed during the three months ended October 29, 2011 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company s financial results.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

4. Goodwill and Purchased Intangible Assets
(a) Goodwill

Beginning in fiscal 2012, the Company s reportable segments were changed to the following segments: the Americas, EMEA, and APJC. As a result, the Company reallocated the goodwill at July 30, 2011 to these reportable segments. The following table presents the goodwill allocated to the Company s reportable segments as of and during the three months ended October 29, 2011 (in millions):

	Balance at July 30, 2011	Acquisitions	Other	Balance at October 29, 2011
Americas	$ 11,627	$ 12	$ (4)	$ 11,635
EMEA	3,272	6	(12)	3,266
APJC	1,919	3		1,922
Total	$ 16,818	$ 21	$ (16)	$ 16,823

In the preceding table, Other includes foreign currency translation and purchase accounting adjustments.

(b) Purchased Intangible Assets

The following table presents details of the Company s intangible assets acquired through business combinations completed during the three months ended October 29, 2011 (in millions, except years):

	FINITE LIVES						INDEFINITE LIVES	
	TECHNOLOGY		CUSTOMER RELATIONSHIPS		OTHER		In-Process Research & Development	TOTAL
	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount	Amount
Total	3.7	$ 19		$		$	$	$ 19

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

October 29, 2011	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	$ 2,128	$ (642)	$ 1,486
Customer relationships	2,269	(1,425)	844

Other	123	(97)	26
Total purchased intangible assets with finite lives	4,520	(2,164)	2,356
In-process research & development, with indefinite lives	13		13
Total	$ 4,533	$ (2,164)	$ 2,369

July 30, 2011	**Gross**	**Accumulated Amortization**	**Net**
Purchased intangible assets with finite lives:			
Technology	$ 1,961	$ (561)	$ 1,400
Customer relationships	2,277	(1,346)	931
Other	123	(91)	32
Total purchased intangible assets with finite lives	4,361	(1,998)	2,363
In-process research & development, with indefinite lives	178		178
Total	$ 4,539	$ (1,998)	$ 2,541

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

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	Three Months Ended	
	October 29, 2011	October 30, 2010
Amortization of purchased intangible assets:		
Cost of sales	$ 96	$ 106
Operating expenses	99	113
Total	$ 195	$ 219

The estimated future amortization expense of purchased intangible assets with finite lives as of October 29, 2011 is as follows (in millions):

Fiscal Year	Amount
2012 (remaining nine months)	$ 580
2013	659
2014	474
2015	404
2016	187
Thereafter	52
Total	$ 2,356

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Restructuring and Other Charges

In fiscal 2011, the Company initiated a number of key, targeted actions to address several areas in its business model. These actions are intended to simplify and focus the Company s organization and operating model; align the Company s cost structure given transitions in the marketplace; divest or exit underperforming operations; and deliver value to the Company s shareholders. The Company is taking these actions to align its business based on its five foundational priorities: leadership in its core business (routing, switching, and associated services) which includes comprehensive security and mobility solutions; collaboration; data center virtualization and cloud; video; and architectures for business transformation. The Company announced in July 2011 that it would incur pretax charges, which are not expected to exceed $1.3 billion, as part of these expense reduction actions. In connection with the July announcement, the Company has incurred cumulative charges of approximately $925 million through October 29, 2011 (included as part of the charges discussed below). The Company expects to complete these restructuring actions by the end of fiscal 2012 with the corresponding restructuring charges recognized during the remainder of fiscal 2012.

During the three months ended October 29, 2011, the Company incurred total restructuring charges of $202 million consisting of $174 million of employee severance charges and $28 million of other restructuring charges. The employee severance charges consisted of $212 million of charges primarily related to impacted employees in the Company s international locations, partially offset by a reduction of $38 million related to a change in estimate regarding certain employee severance charges incurred in the fourth quarter of fiscal 2011. Other charges incurred during the three months ended October 29, 2011 were primarily for the consolidation of excess facilities, as well as an incremental charge related to the sale of the Company s Juarez, Mexico manufacturing operations, which sale was completed in the first quarter of fiscal 2012.

The following table summarizes the activity related to the restructuring and other charges related to the Company s July 2011 announcement and the realignment and restructuring of the Company s consumer product lines announced during the third quarter of fiscal 2011 (in millions):

	Voluntary Early Retirement Program	Employee Severance	Goodwill and Intangible Assets	Other	Total
Initial charges in fiscal 2011	$ 453	$ 247	$ 71	$ 28	$ 799
Cash payments	(436)	(13)			(449)
Non-cash items			(71)	(17)	(88)
Balance as of July 30, 2011	17	234		11	262
Charges		174		28	202
Cash payments	(17)	(276)		(4)	(297)
Non-cash items				(18)	(18)
Balance as of October 29, 2011	$	$ 132	$	$ 17	$ 149

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Balance Sheet Details

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

	October 29, 2011	July 30, 2011
Inventories:		
Raw materials	$ 193	$ 219
Work in process	43	52
Finished goods:		
Distributor inventory and deferred cost of sales	684	631
Manufactured finished goods	437	331
Total finished goods	1,121	962
Service-related spares	195	182
Demonstration systems	70	71
Total	$ 1,622	$ 1,486
Property and equipment, net:		
Land, buildings, and building & leasehold improvements	$ 4,616	$ 4,760
Computer equipment and related software	1,410	1,429
Production, engineering, and other equipment	5,075	5,093
Operating lease assets [1]	293	293
Furniture and fixtures	486	491
	11,880	12,066
Less accumulated depreciation and amortization [1]	(8,127)	(8,150)
Total	$ 3,753	$ 3,916

[1] Accumulated depreciation related to operating lease assets was $171 and $169 as of October 29, 2011 and July 30, 2011, respectively.

Other assets:		
Deferred tax assets	$ 1,895	$ 1,864
Investments in privately held companies	898	796
Other	750	441
Total	$ 3,543	$ 3,101

Deferred revenue:

Service	$ 8,321	$ 8,521
Product:		
Unrecognized revenue on product shipments and other deferred revenue	3,209	3,003
Cash receipts related to unrecognized revenue from two-tier distributors	866	683
Total product deferred revenue	4,075	3,686
Total	$ 12,396	$ 12,207
Reported as:		
Current	$ 8,444	$ 8,025
Noncurrent	3,952	4,182
Total	$ 12,396	$ 12,207

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Financing Receivables and Guarantees

(a) Financing Receivables

Financing receivables primarily consist of lease receivables, loan receivables, and financed service contracts and other. Lease receivables represent sales-type and direct-financing leases resulting from the sale of the Company 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 while loan receivables generally have terms of up to three years. The financed service contracts and other category includes financing receivables related to technical support and other services, as well as an insignificant amount of receivables related to financing of certain indirect costs associated with leases. 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 the Company s financing receivables is presented as follows (in millions):

October 29, 2011	Lease Receivables	Loan Receivables	Financed Service Contracts & Other [1]	Total Financing Receivables
Gross	$ 3,086	$ 1,468	$ 2,557	$ 7,111
Unearned income	(237)			(237)
Allowance for credit loss	(233)	(103)	(29)	(365)
Total, net	$ 2,616	$ 1,365	$ 2,528	$ 6,509
Reported as:				
Current	$ 1,054	$ 861	$ 1,385	$ 3,300
Noncurrent	1,562	504	1,143	3,209
Total, net	$ 2,616	$ 1,365	$ 2,528	$ 6,509

July 30, 2011	Lease Receivables	Loan Receivables	Financed Service Contracts & Other [1]	Total Financing Receivables
Gross	$ 3,111	$ 1,468	$ 2,637	$ 7,216
Unearned income	(250)			(250)
Allowance for credit loss	(237)	(103)	(27)	(367)
Total, net	$ 2,624	$ 1,365	$ 2,610	$ 6,599
Reported as:				
Current	$ 1,087	$ 673	$ 1,351	$ 3,111
Noncurrent	1,537	692	1,259	3,488
Total, net	$ 2,624	$ 1,365	$ 2,610	$ 6,599

(1) As of October 29, 2011 and July 30, 2011, the deferred service revenue related to financed service contracts and other was $1,940 million and $2,044 million, respectively.

Contractual maturities of the gross lease receivables at October 29, 2011 are summarized as follows (in millions):

Fiscal Year	Amount
2012 (remaining nine months)	$ 978
2013	988
2014	677
2015	325
2016	109
Thereafter	9
Total	$ 3,086

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

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Credit Quality of Financing Receivables

Financing receivables categorized by the Company s internal credit risk rating for each portfolio segment and class as of October 29, 2011 and July 30, 2011 are summarized as follows (in millions):

	INTERNAL CREDIT RISK RATING					
October 29, 2011	**1 to 4**	**5 to 6**	**7 and Higher**	**Total**	**Residual Value**	**Gross Receivables, Net of Unearned Income**
Established Markets						
Lease receivables	$ 1,193	$ 1,190	$ 20	$ 2,403	$ 291	$ 2,694
Loan receivables	206	258	6	470		470
Financed service contracts & other	1,610	870	49	2,529		2,529
Total Established Markets	$ 3,009	$ 2,318	$ 75	$ 5,402	$ 291	$ 5,693
Growth Markets						
Lease receivables	$ 51	$ 90	$ 10	$ 151	$ 4	$ 155
Loan receivables	428	554	16	998		998
Financed service contracts & other	5	19	4	28		28
Total Growth Markets	$ 484	$ 663	$ 30	$ 1,177	$ 4	$ 1,181
Total	$ 3,493	$ 2,981	$ 105	$ 6,579	$ 295	$ 6,874

	INTERNAL CREDIT RISK RATING					
July 30, 2011	**1 to 4**	**5 to 6**	**7 and Higher**	**Total**	**Residual Value**	**Gross Receivables, Net of Unearned Income**
Established Markets						
Lease receivables	$ 1,214	$ 1,182	$ 23	$ 2,419	$ 292	$ 2,711
Loan receivables	204	187	4	395		395
Financed service contracts & other	1,622	939	52	2,613		2,613
Total Established Markets	$ 3,040	$ 2,308	$ 79	$ 5,427	$ 292	$ 5,719
Growth Markets						
Lease receivables	$ 35	$ 93	$ 18	$ 146	$ 4	$ 150

Loan receivables	458	580	35	1,073		1,073
Financed service contracts & other	1	19	4	24		24
Total Growth Markets	$ 494	$ 692	$ 57	$ 1,243	$ 4	$ 1,247
Total	$ 3,534	$ 3,000	$ 136	$ 6,670	$ 296	$ 6,966

The Company s 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 and constitute a relatively small portion of the Company s financing receivables.

The financing receivables are disaggregated into two classes: the Established Markets and Growth Markets . The Growth Markets class primarily consists of emerging countries including Brazil, Russia, India, China and Mexico, among others. The Established Markets class consists of countries other than the emerging countries in which the Company has financing receivables.

In circumstances when collectability is not deemed reasonably assured, the associated revenue is deferred in accordance with the Company s revenue recognition policies, and the related allowance for credit loss, if any, is included in deferred revenue. The Company also records deferred revenue associated with financing receivables when there are remaining performance obligations, as it does for financed service contracts. Total allowances for credit loss and deferred revenue as of October 29, 2011 and July 30, 2011 were $2,644 million and $2,793 million, respectively and they were associated with financing receivables (net of unearned income) of $6,874 million, and $6,966 million as of their respective period ends. The losses that the Company has incurred historically as well as in the periods presented with respect to its financing receivables have been immaterial and consistent with the performance of an investment-grade portfolio.

As of October 29, 2011 and July 30, 2011, the portion of the portfolio that was deemed to be impaired, generally with a credit risk rating of 8 or higher, was immaterial. The total net write-offs of financing receivables were not material for the first quarter of fiscal 2012. During the first quarter of fiscal 2012, the Company did not modify any financing receivables.

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(Unaudited)

The following table presents the aging analysis of financing receivables by portfolio segment and class as of October 29, 2011 and July 30, 2011 (in millions):

October 29, 2011 **Established Markets**	**31-60 Days Past Due (1)**	**61-90 Days Past Due (1)**	**Greater than 90 Days Past Due (1) (2)**	**Total Past Due**	**Current**	**Gross Receivables, Net of Unearned Income**	**Non-Accrual Financing Receivables**	**Impaired Financing Receivables**
Lease receivables	$ 103	$ 75	$ 127	$ 305	$ 2,389	$ 2,694	$ 18	$ 6
Loan receivables	3	4	9	16	454	470	2	2
Financed service contracts & other	64	97	241	402	2,127	2,529	14	6
Total Established Markets	$ 170	$ 176	$ 377	$ 723	$ 4,970	$ 5,693	$ 34	$ 14
Growth Markets								
Lease receivables	$ 4	$ 5	$ 2	$ 11	$ 144	$ 155	$ 9	$ 9
Loan receivables	2		3	5	993	998	4	3
Financed service contracts & other					28	28		
Total Growth Markets	$ 6	$ 5	$ 5	$ 16	$ 1,165	$ 1,181	$ 13	$ 12
Total	$ 176	$ 181	$ 382	$ 739	$ 6,135	$ 6,874	$ 47	$ 26

July 30, 2011 **Established Markets**	**31-60 Days Past Due (1)**	**61-90 Days Past Due (1)**	**Greater than 90 Days Past Due (1) (2)**	**Total Past Due**	**Current**	**Gross Receivables, Net of Unearned Income**	**Non-Accrual Financing Receivables**	**Impaired Financing Receivables**
Lease receivables	$ 85	$ 33	$ 139	$ 257	$ 2,454	$ 2,711	$ 16	$ 6
Loan receivables	6	1	9	16	379	395	1	1
Financed service contracts & other	68	33	265	366	2,247	2,613	17	6
Total Established Markets	$ 159	$ 67	$ 413	$ 639	$ 5,080	$ 5,719	$ 34	$ 13
Growth Markets								
Lease receivables	$ 4	$ 2	$ 13	$ 19	$ 131	$ 150	$ 18	$ 18
Loan receivables	2	6	12	20	1,053	1,073	3	3
Financed service contracts & other					24	24		

Total Growth Markets	$ 6	$ 8	$ 25	$ 39	$ 1,208	$ 1,247	$ 21	$ 21
Total	$ 165	$ 75	$ 438	$ 678	$ 6,288	$ 6,966	$ 55	$ 34

(1) 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 are 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 preceding aging tables also exclude pending adjustments on billed tax assessment in certain international markets.

(2) The balances of either unbilled or current financing receivables included in the greater-than-90 days past due category for lease receivables, loan receivables, and financed service contracts and other were $102 million, $10 million, and $212 million, respectively, as of October 29, 2011. Such balances for the same category of receivables were $116 million, $15 million, and $230 million, respectively, as of July 30, 2011.

As of October 29, 2011, the Company had financing receivables of $48 million, net of unbilled or current receivables from the same contract, that were in the greater-than 90 days past due category but remained on accrual status. Such balance was $50 million as of July 30, 2011. A financing receivable may be placed on non-accrual status earlier if, in management s opinion, a timely collection of the full principal and interest becomes uncertain.

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(c) Allowance for Credit Loss Rollforward

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

	CREDIT LOSS ALLOWANCES			
Three Months Ended October 29, 2011	**Lease Receivables**	**Loan Receivables**	**Financed Service Contracts and Other**	**Total**
Allowance for credit loss as of July 30, 2011	$ 237	$ 103	$ 27	$ 367
Provisions	2	5	2	9
Foreign exchange and other	(6)	(5)		(11)
Allowance for credit loss as of October 29, 2011	$ 233	$ 103	$ 29	$ 365
Gross receivables as of October 29, 2011, net of unearned income	$ 2,849	$ 1,468	$ 2,557	$ 6,874

Financing receivables that were individually evaluated for impairment during the three month period ended October 29, 2011 were not material and therefore are not presented separately in the preceding table.

(d) Financing Guarantees

In the ordinary course of business, the Company provides 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 The Company facilitates 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, the Company guarantees a portion of these arrangements. The volume of channel partner financing was $5.3 billion and $4.5 billion for the three months ended October 29, 2011 and October 30, 2010, respectively. The balance of the channel partner financing subject to guarantees was $1.5 billion as of October 29, 2011 and $1.4 billion as of July 30, 2011.

End-User Financing Guarantees The Company also provides financing guarantees for third-party financing arrangements extended to end-user customers related to leases and loans that typically have terms of up to three years. The volume of financing provided by third parties for leases and loans for the three months ended October 29, 2011 and October 30, 2010 was $411 million and $283 million, respectively. The volume of financing for which the Company has provided guarantees was $35 million for each of the respective periods.

Financing Guarantee Summary The aggregate amount of financing guarantees outstanding at October 29, 2011 and July 30, 2011, 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):

	October 29, 2011	**July 30, 2011**
Maximum potential future payments relating to financing guarantees:		
Channel partner	$ 349	$ 336
End user	259	277

Total	$	608	$	613
Deferred revenue associated with financing guarantees:				
Channel partner	$	(261)	$	(248)
End user		(234)		(248)
Total	$	(495)	$	(496)
Maximum potential future payments relating to financing guarantees, net of associated deferred revenue	$	113	$	117

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(Unaudited)

8. Investments

(a) Summary of Available-for-Sale Investments

The following tables summarize the Company s available-for-sale investments (in millions):

October 29, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
U.S. government securities	$ 20,206	$ 53	$ (5)	$ 20,254
U.S. government agency securities [1]	10,026	27	(4)	10,049
Non-U.S. government and agency securities [2]	3,516	12	(3)	3,525
Corporate debt securities	4,299	44	(23)	4,320
Asset-backed securities	116	4	(4)	116
Total fixed income securities	38,163	140	(39)	38,264
Publicly traded equity securities	777	603	(3)	1,377
Total	$ 38,940	$ 743	$ (42)	$ 39,641

July 30, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
U.S. government securities	$ 19,087	$ 52	$	$ 19,139
U.S. government agency securities [1]	8,742	35	(1)	8,776
Non-U.S. government and agency securities [2]	3,119	14	(1)	3,132
Corporate debt securities	4,333	65	(4)	4,394
Asset-backed securities	120	5	(4)	121
Total fixed income securities	35,401	171	(10)	35,562
Publicly traded equity securities	734	639	(12)	1,361
Total	$ 36,135	$ 810	$ (22)	$ 36,923

(1) Includes corporate debt securities that are guaranteed by the Federal Deposit Insurance Corporation (FDIC).

(2) Includes agency and corporate debt securities that are guaranteed by non-U.S. governments.

(b) Gains and Losses on Available-for-Sale Investments

The following table presents the net realized gains (losses) related to the Company s available-for-sale investments (in millions):

Three Months Ended	**October 29, 2011**	**October 30, 2010**
Net realized gains (losses):		
Publicly traded equity securities	$ (16)	$ 19
Fixed income securities	25	71
Total	$ 9	$ 90

There were no material impairment charges on available-for-sale investments for the three months ended October 29, 2011 and October 30, 2010.

The following table summarizes the activity related to credit losses for fixed income securities (in millions):

	October 29, 2011	**October 30, 2010**
Balance at beginning of period	$ (23)	$ (95)
Sales of other-than-temporarily impaired fixed income securities		27
Balance at end of period	$ (23)	$ (68)

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following tables present the breakdown of the available-for-sale investments with gross unrealized losses and the duration that those losses had been unrealized at October 29, 2011 and July 30, 2011 (in millions):

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 12 MONTHS OR GREATER		TOTAL	
October 29, 2011	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Fixed income securities:						
U.S. government securities	$ 4,767	$ (5)	$	$	$ 4,767	$ (5)
U.S. government agency securities [1]	2,490	(4)			2,490	(4)
Non-U.S. government and agency securities [2]	1,603	(3)			1,603	(3)
Corporate debt securities	1,528	(19)	68	(4)	1,596	(23)
Asset-backed securities			101	(4)	101	(4)
Total fixed income securities	10,388	(31)	169	(8)	10,557	(39)
Publicly traded equity securities	25	(3)			25	(3)
Total	$ 10,413	$ (34)	$ 169	$ (8)	$ 10,582	$ (42)

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 12 MONTHS OR GREATER		TOTAL	
July 30, 2011	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**
Fixed income securities:						
U.S. government agency securities [1]	$ 2,310	$ (1)	$	$	$ 2,310	$ (1)
Non-U.S. government and agency securities [2]	875	(1)			875	(1)
Corporate debt securities	548	(2)	56	(2)	604	(4)
Asset-backed securities			105	(4)	105	(4)
Total fixed income securities	3,733	(4)	161	(6)	3,894	(10)
Publicly traded equity securities	112	(12)			112	(12)
Total	$ 3,845	$ (16)	$ 161	$ (6)	$ 4,006	$ (22)

(1) Includes corporate debt securities that are guaranteed by the FDIC.

(2) Includes agency and corporate debt securities that are guaranteed by non-U.S. governments.

For fixed income securities that have unrealized losses as of October 29, 2011, the Company has determined that (i) it does not have the intent to sell any of these investments and (ii) it is not more likely than not that it will be required to sell any of these investments before recovery of the entire amortized cost basis. In addition, as of October 29, 2011, the Company anticipates that it will recover the entire amortized cost basis of such fixed income securities and has determined that no other-than-temporary impairments associated with credit losses were required to be recognized during the three months ended October 29, 2011.

The Company has evaluated its publicly traded equity securities as of October 29, 2011 and has determined that there was no indication of other-than-temporary impairments in the respective categories of unrealized losses. This determination was based on several factors, which include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the issuer, and the Company s intent and ability to hold the publicly traded equity securities for a period of time sufficient to allow for any anticipated recovery in market value.

(c) Maturities of Fixed Income Securities

The following table summarizes the maturities of the Company s fixed income securities at October 29, 2011 (in millions):

	Amortized Cost	Fair Value
Less than 1 year	$ 18,989	$ 19,017
Due in 1 to 2 years	11,927	11,971
Due in 2 to 5 years	7,045	7,069
Due after 5 years	202	207
Total	$ 38,163	$ 38,264

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

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(d) Securities Lending

The Company periodically engages in securities lending activities with certain of its available-for-sale 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 balance of securities lending for the three months ended October 29, 2011 and October 30, 2010 was $1.7 billion and $2.1 billion, respectively. The Company requires collateral equal to at least 102% of the fair market value of the loaned security in the form of cash or liquid, high-quality assets. The Company engages in these secured lending transactions only with highly creditworthy counterparties, and the associated portfolio custodian has agreed to indemnify the Company against any collateral losses. The Company did not experience any losses in connection with the secured lending of securities during the periods presented. As of October 29, 2011 and July 30, 2011, the Company had no outstanding securities lending transactions.

9. 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 recorded at fair value, the Company considers the principal or most advantageous market in which it would transact, and it considers 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 Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2 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 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.

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

Assets and liabilities measured at fair value on a recurring basis as of October 29, 2011 and July 30, 2011 were as follows (in millions):

	OCTOBER 29, 2011 FAIR VALUE MEASUREMENTS				JULY 30, 2011 FAIR VALUE MEASUREMENTS			
	Level 1	Level 2	Level 3	Total Balance	Level 1	Level 2	Level 3	Total Balance

Assets								
Cash equivalents:								
Money market funds	$ 3,136	$	$	$ 3,136	$ 5,852	$	$	$ 5,852
U.S. government agency securities [1]						1		1
Available-for-sale investments:								
U.S. government securities		20,254		20,254		19,139		19,139
U.S. government agency securities [1]		10,049		10,049		8,776		8,776
Non-U.S. government and agency securities [2]		3,525		3,525		3,132		3,132
Corporate debt securities		4,320		4,320		4,394		4,394
Asset-backed securities			116	116			121	121
Publicly traded equity securities	1,377			1,377	1,361			1,361
Derivative assets		242	1	243		220	2	222
Total	$ 4,513	$ 38,390	$ 117	$ 43,020	$ 7,213	$ 35,662	$ 123	$ 42,998
Liabilities:								
Derivative liabilities	$	$ 42	$	$ 42	$	$ 24	$	$ 24
Total	$	$ 42	$	$ 42	$	$ 24	$	$ 24

(1) Includes corporate debt securities that are guaranteed by the FDIC.

(2) Includes agency and corporate debt securities that are guaranteed by non-U.S. governments.

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Level 2 fixed income securities are priced using quoted market prices for similar instruments or nonbinding market prices that are corroborated by observable market data. The Company uses 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. The Company uses such pricing data as the primary input to make its assessments and determinations as to the ultimate valuation of its investment portfolio and has not made, during the periods presented, any material adjustments to such inputs. The Company is ultimately responsible for the financial statements and underlying estimates. The Company s 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. The Company did not have any transfers between Level 1 and Level 2 fair value measurements during the periods presented.

Level 3 assets include asset-backed securities and certain derivative instruments, the values of which are determined based on discounted cash flow models using inputs that the Company could not corroborate with market data.

The following tables present a reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended October 29, 2011 and October 30, 2010 (in millions):

	Asset-Backed Securities	Derivative Assets	Total
Balance at July 30, 2011	$ 121	$ 2	$ 123
Total gains and losses (realized and unrealized):			
Included in other income, net		(1)	(1)
Sales and maturities	(5)		(5)
Balance at October 29, 2011	$ 116	$ 1	$ 117
Losses attributable to assets still held as of October 29, 2011	$	$ (1)	$ (1)

	Asset-Backed Securities	Derivative Assets	Total
Balance at July 31, 2010	$ 149	$ 3	$ 152
Total gains and losses (realized and unrealized):			
Included in other income, net		(1)	(1)
Included in other comprehensive income	(1)		(1)
Sales and maturities	(6)		(6)
Balance at October 30, 2010	$ 142	$ 2	$ 144
Losses attributable to assets still held as of October 30, 2010	$	$ (1)	$ (1)

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

The following tables present the Company s financial instruments and nonfinancial assets that were measured at fair value on a nonrecurring basis during the indicated periods and the related recognized gains and losses for the periods (in millions):

FAIR VALUE MEASUREMENTS USING

	Net Carrying Value as of October 29, 2011	Level 1	Level 2	Level 3	Total Losses for the Three Months Ended October 29, 2011
Investments in privately held companies	$ 1	$	$	$ 1	$ 1
Property held for sale	$ 24	$	$	$ 24	89
Total					$ 90

		FAIR VALUE MEASUREMENTS USING			
	Net Carrying Value as of October 30, 2010	Level 1	Level 2	Level 3	Total Losses for the Three Months Ended October 30, 2010
Investments in privately held companies	$ 9	$	$	$ 9	$ 3

The assets in the preceding tables were classified as Level 3 assets because the Company used unobservable inputs to value them, reflecting the Company s assessment of the assumptions market participants would use in pricing these assets due to the absence of quoted market prices and the inherent lack of liquidity. These assets were measured at fair value due to events or circumstances the Company identified as having significantly impacted the fair value during the respective indicated periods.

The fair value for investments in privately held companies was measured using financial metrics, comparison to other private and public companies, and analysis of the financial condition and near-term prospects of the issuers, including recent financing activities and their capital structure as well as other economic variables. The impairment as a result of the evaluation for the investments in privately held companies was recorded to other income, net.

The fair value of property held for sale was measured using discounted cash flow techniques.

(d) Other

The fair value of certain of the Company s financial instruments that are not measured at fair value, including accounts receivable, accounts payable, accrued compensation and other current liabilities, approximates the carrying amount because of their short maturities. In addition, the fair value of the Company s loan receivables and financed service contracts also approximates the carrying amount. The fair value of the Company s debt is disclosed in Note 10 and was determined using quoted market prices for those securities.

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CISCO SYSTEMS, INC.

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(Unaudited)

10. Borrowings

(a) Short-Term Debt

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

	October 29, 2011		July 30, 2011	
	Amount	Weighted-Average Interest Rate	Amount	Weighted-Average Interest Rate
Commercial paper	$ 500	0.13 %	$ 500	0.14 %
Other notes and borrowings	89	6.12 %	88	4.59 %
Total short-term debt	$ 589		$ 588	

In fiscal 2011, the Company established a short-term debt financing program of up to $3.0 billion through the issuance of commercial paper notes. The Company used the proceeds from the issuance of commercial paper notes for general corporate purposes, including repayment of matured debt, if applicable. The outstanding commercial paper as of October 29, 2011 and July 30, 2011 had maturity dates of approximately three months or less.

Other notes and borrowings in the preceding table consist of notes and credit facilities established with a number of financial institutions that are available to certain foreign subsidiaries of the Company. These notes and credit facilities are subject to various terms and foreign currency market interest rates pursuant to individual financial arrangements between the financing institution and the applicable foreign subsidiary.

As of October 29, 2011, the estimated fair value of the short-term debt approximates its carrying value due to the short maturities.

(b) Long-Term Debt

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

	October 29, 2011		July 30, 2011	
	Amount	Effective Rate	Amount	Effective Rate
Senior Notes:				
Floating-rate notes, due 2014	$ 1,250	0.69 %	$ 1,250	0.60 %
2.90% fixed-rate notes, due 2014	500	3.11 %	500	3.11 %
1.625% fixed-rate notes, due 2014	2,000	0.67 %	2,000	0.58 %
5.50% fixed-rate notes, due 2016	3,000	3.08 %	3,000	3.06 %
3.15% fixed-rate notes, due 2017	750	0.91 %	750	0.81 %
4.95% fixed-rate notes, due 2019	2,000	5.08 %	2,000	5.08 %
4.45% fixed-rate notes, due 2020	2,500	4.50 %	2,500	4.50 %
5.90% fixed-rate notes, due 2039	2,000	6.11 %	2,000	6.11 %
5.50% fixed-rate notes, due 2040	2,000	5.67 %	2,000	5.67 %
Total	16,000		16,000	
Unaccreted discount	(72)		(73)	

Hedge accounting adjustment	336	307
Total long-term debt	$ 16,264	$ 16,234

To achieve its interest rate risk management objectives, the Company entered into interest rate swaps with an aggregate notional amount of $4.25 billion designated as fair value hedges of certain fixed-rate senior notes. In effect, 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. See Note 11.

The effective rates for the fixed-rate debt include the interest on the notes, the accretion of the discount, and, if applicable, adjustments related to hedging. Based on market prices, the fair value of the Company s long-term debt was $17.9 billion as of October 29, 2011.

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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 the Company at any time, subject to a make-whole premium.

The senior notes rank at par with the issued commercial paper notes, as well as any other commercial paper notes that may be issued in the future pursuant to the short-term debt financing program, as discussed earlier under Short-Term Debt. The Company was in compliance with all debt covenants as of October 29, 2011.

Future principal payments for long-term debt as of October 29, 2011 are summarized as follows (in millions):

Fiscal Year	Amount
2014	$ 3,250
2015	500
2016	3,000
Thereafter	9,250
Total	$ 16,000

(c) Credit Facility

The Company has a credit agreement with certain institutional lenders providing for a $3.0 billion unsecured revolving credit facility that is scheduled to expire on August 17, 2012. Any advances under the credit agreement will accrue interest at rates that are equal to, based on certain conditions, either (i) the higher of the Federal Funds rate plus 0.50% or Bank of America s prime rate as announced from time to time or (ii) LIBOR plus a margin that is based on the Company s senior debt credit ratings as published by Standard & Poor s Ratings Services and Moody s Investors Service, Inc. The credit agreement requires the Company to comply with certain covenants, including that it maintain an interest coverage ratio as defined in the agreement. The Company was in compliance with the required interest coverage ratio and the other covenants as of October 29, 2011.

The Company 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 $1.9 billion and/or extend the expiration date of the credit facility up to August 15, 2014. As of October 29, 2011, the Company had not borrowed any funds under the credit facility.

11. Derivative Instruments

(a) Summary of Derivative Instruments

The Company uses derivative instruments primarily to manage exposures to foreign currency exchange rate, interest rate, and equity price risks. The Company s 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. The Company s derivatives expose it to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company does, however, seek to mitigate such risks by limiting its 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 the Company s 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	October 29, 2011	July 30, 2011	Balance Sheet Line Item	October 29, 2011	July 30, 2011
Derivatives designated as hedging instruments:						
Foreign currency derivatives	Other current assets	$ 32	$ 67	Other current liabilities	$ 30	$ 12
Interest rate derivatives	Other assets	180	146	Other long-term liabilities		
Total		$ 212	$ 213		$ 30	$ 12
Derivatives not designated as hedging instruments:						
Foreign currency derivatives	Other current assets	$ 30	$ 7	Other current liabilities	$ 12	$ 12
Equity derivatives	Other assets	1	2	Other long-term liabilities		
Total		31	9		12	12
Total		$ 243	$ 222		$ 42	$ 24

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Derivatives Designated as Cash Flow Hedging Instruments	GAINS (LOSSES) RECOGNIZED IN OCI ON DERIVATIVES FOR THE THREE MONTHS ENDED (EFFECTIVE PORTION) October 29, 2011	October 30, 2010	Line Item in Statements of Operations	GAINS (LOSSES) RECLASSIFIED FROM AOCI INTO INCOME FOR THE THREE MONTHS ENDED October 29, 2011	October 30, 2010
Foreign currency derivatives	$ (50)	$ 55	Operating expenses	$	$ 6
			Cost of sales service		1
Total	$ (50)	$ 55		$	$ 7

During the three months ended October 29, 2011 and October 30, 2010, the amounts recognized in earnings on derivative instruments designated as cash flow hedges related to the ineffective portion were not material, and the Company did not exclude any component of the changes in fair value of the derivative instruments from the assessment of hedge effectiveness. As of October 29, 2011, the Company estimates that approximately $32 million of net derivative losses related to its cash flow hedges included in AOCI will be reclassified into earnings within the next 12 months.

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 DERIVATIVES INSTRUMENTS FOR THE THREE MONTHS ENDED October 29, 2011	October 30, 2010	GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE THREE MONTHS ENDED October 29, 2011	October 30, 2010
Interest rate derivatives	Interest expense	$ 35	$ 30	$ (36)	$ (32)

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	Line Item in Statements	GAINS (LOSSES) FOR THE THREE MONTHS ENDED October 29, 2011	October 30, 2010

Hedging Instruments	of Operations		
Foreign currency derivatives	Other income, net	$ (57)	$ 114
Total return swaps-deferred compensation	Operating expenses	(20)	11
Equity derivatives	Other income, net	7	5
Total		$ (70)	$ 130

The notional amounts of the Company s outstanding derivatives are summarized as follows (in millions):

	October 29, 2011	July 30, 2011
Derivatives designated as hedging instruments:		
Foreign currency derivatives cash flow hedges	$ 2,707	$ 3,433
Interest rate derivatives	4,250	4,250
Net investment hedging instruments	68	73
Derivatives not designated as hedging instruments:		
Foreign currency derivatives	5,220	4,565
Total return swaps	262	262
Total	$ 12,507	$ 12,583

(b) Foreign Currency Exchange Risk

The Company conducts business globally in numerous currencies. Therefore, it is exposed to adverse movements in foreign currency exchange rates. To limit the exposure related to foreign currency changes, the Company enters into foreign currency contracts. The Company does not enter into such contracts for trading purposes.

The Company hedges foreign currency forecasted transactions related to certain operating expenses and service cost of sales with currency options and forward contracts. These currency option and forward contracts, designated as cash flow hedges, generally have maturities of less than 18 months. The Company assesses 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 fiscal years presented, the Company did not discontinue any cash flow hedge for which it was probable that a forecasted transaction would not occur.

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(Unaudited)

The Company enters 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, 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.

The Company hedges certain net investments in its foreign subsidiaries with forward contracts, which generally have maturities of up to six months. The Company recognized a loss of $4 million and $5 million in OCI for the effective portion of its net investment hedges for the three months ended October 29, 2011 and October 30, 2010, respectively.

(c) Interest Rate Risk

Interest Rate Derivatives, Investments The Company s primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. To realize these objectives, the Company may utilize interest rate swaps or other derivatives designated as fair value or cash flow hedges. As of October 29, 2011 and July 30, 2011 the Company did not have any outstanding interest rate derivatives related to its fixed income securities.

Interest Rate Derivatives Designated as Fair Value Hedge, Long-Term Debt In fiscal 2011, the Company entered into interest rate swaps designated as fair value hedges related to fixed-rate senior notes that were issued in March 2011 and are due in 2014 and 2017. In fiscal 2010, the Company entered into interest rate swaps designated as fair value hedges for a portion of senior fixed-rate notes that were issued in 2006 and are due in 2016. Under these interest rate swaps, the Company receives fixed-rate interest payments and makes 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.

(d) Equity Price Risk

The Company may hold equity securities for strategic purposes or to diversify its overall investment portfolio. The publicly traded equity securities in the Company s portfolio are subject to price risk. To manage its exposure to changes in the fair value of certain equity securities, the Company may enter 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, the Company periodically manages the risk of its investment portfolio by entering into equity derivatives that are not designated as accounting hedges. The changes in the fair value of these derivatives were also included in other income (loss), net. The Company did not have any equity derivatives outstanding related to its investment portfolio at October 29, 2011 and July 30, 2011.

The Company is also exposed to variability in compensation charges related to certain deferred compensation obligations to employees. Although not designated as accounting hedges, the Company utilizes derivatives such as total return swaps to economically hedge this exposure. The fair value of such derivative instruments was negligible as of October 29, 2011.

(e) Credit-Risk-Related Contingent Features

Certain derivative instruments are executed under agreements that have provisions requiring the Company and the counterparty to maintain a specified credit rating from certain credit rating agencies. If the Company s or the counterparty s credit rating falls below a specified credit rating, either party has the right to request collateral on the derivatives net liability position. Such provisions did not affect the Company s financial position as of October 29, 2011 and July 30, 2011.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Commitments and Contingencies

(a) Operating Leases

The Company leases office space in several U.S. locations. Outside the United States, larger leased sites include sites in Australia, Belgium, China, Germany, India, Israel, Italy, Japan, Norway, and the United Kingdom. The Company also leases equipment and vehicles. Future minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of October 29, 2011 are as follows (in millions):

Fiscal Year	Amount
2012 (remaining nine months)	$ 253
2013	256
2014	189
2015	155
2016	67
Thereafter	267
Total	$ 1,187

(b) Purchase Commitments with Contract Manufacturers and Suppliers

The Company purchases components from a variety of suppliers and uses several contract manufacturers to provide manufacturing services for its products. During the normal course of business, in order to manage manufacturing lead times and help ensure adequate component supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by the Company or that establish the parameters defining the Company s requirements. A significant portion of the Company s reported purchase commitments arising from these agreements consists of firm, noncancelable, and unconditional commitments. In certain instances, these agreements allow the Company the option to cancel, reschedule, and adjust the Company s requirements based on its business needs prior to firm orders being placed. As of October 29, 2011 and July 30, 2011, the Company had total purchase commitments for inventory of $4.178 billion and $4.313 billion, respectively.

The Company records a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of its future demand forecasts consistent with the valuation of the Company s excess and obsolete inventory. As of October 29, 2011 and July 30, 2011, the liability for these purchase commitments was $164 million and $168 million, respectively, and was included in other current liabilities.

(c) Other Commitments

In connection with the Company s business combinations and asset purchases, the Company has agreed to pay certain additional amounts contingent upon the achievement of certain agreed-upon-technology, development, product, or other milestones or the continued employment with the Company of certain employees of the acquired entities. The Company recognized such compensation expense of $14 million and $37 million during the three months ended October 29, 2011 and October 30, 2010, respectively. The largest component of this compensation expense during both periods was related to milestone payments made to former noncontrolling interest holders of Nuova Systems, Inc., the remaining interest of which the Company purchased in fiscal 2008. As of October 29, 2011, the Company estimated that future compensation expense and contingent consideration of up to $53 million may be required to be recognized pursuant to the applicable business combination and asset purchase agreements.

The Company also has certain funding commitments, primarily related to its investments in privately held companies and venture funds, 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 $145 million and $192 million as of October 29, 2011 and July 30, 2011, respectively.

(d) Variable Interest Entities

In the ordinary course of business, the Company has investments in privately held companies and provides financing to certain customers. These privately held companies and customers may be considered to be variable interest entities. The Company evaluates on an ongoing basis its investments in these privately held companies and its customer financings and has determined that as of October 29, 2011 there were no material unconsolidated variable interest entities.

VCE is a joint venture that the Company formed in fiscal 2010 with EMC Corporation (EMC), w