

CISCO SYSTEMS, INC.
Form 10-Q
February 19, 2013

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, 2013

OR

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

For the transition period from _____ to _____

Commission file number 0-18225

CISCO SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

California

(State or other jurisdiction of
incorporation or organization)

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)

77-0059951

(I.R.S. Employer

Identification Number)

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

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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, 2013: 5,331,973,900

Cisco Systems, Inc.
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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CISCO SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except par value)

(Unaudited)

	January 26, 2013	July 28, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$6,847	\$9,799
Investments	39,529	38,917
Accounts receivable, net of allowance for doubtful accounts of \$218 at January 26, 2013 and \$207 at July 28, 2012	4,462	4,369
Inventories	1,574	1,663
Financing receivables, net	3,894	3,661
Deferred tax assets	2,297	2,294
Other current assets	2,122	1,230
Total current assets	60,725	61,933
Property and equipment, net	3,403	3,402
Financing receivables, net	3,837	3,585
Goodwill	21,361	16,998
Purchased intangible assets, net	3,542	1,959
Other assets	3,510	3,882
TOTAL ASSETS	\$96,378	\$91,759
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	\$37	\$31
Accounts payable	890	859
Income taxes payable	87	276
Accrued compensation	2,921	2,928
Deferred revenue	9,108	8,852
Other current liabilities	4,907	4,785
Total current liabilities	17,950	17,731
Long-term debt	16,254	16,297
Income taxes payable	1,340	1,844
Deferred revenue	4,213	4,028
Other long-term liabilities	1,096	558
Total liabilities	40,853	40,458
Commitments and contingencies (Note 12)		
Equity:		
Cisco shareholders' equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	—	—
Common stock and additional paid-in capital, \$0.001 par value: 20,000 shares authorized; 5,323 and 5,298 shares issued and outstanding at January 26, 2013 and July 28, 2012, respectively	39,970	39,271
Retained earnings	14,647	11,354
Accumulated other comprehensive income	898	661
Total Cisco shareholders' equity	55,515	51,286
Noncontrolling interests	10	15

Total equity	55,525	51,301
TOTAL LIABILITIES AND EQUITY	\$96,378	\$91,759

See Notes to Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
NET SALES:				
Product	\$9,437	\$9,118	\$18,734	\$18,070
Service	2,661	2,409	5,240	4,713
Total net sales	12,098	11,527	23,974	22,783
COST OF SALES:				
Product	3,857	3,650	7,605	7,213
Service	898	812	1,787	1,615
Total cost of sales	4,755	4,462	9,392	8,828
GROSS MARGIN	7,343	7,065	14,582	13,955
OPERATING EXPENSES:				
Research and development	1,452	1,339	2,883	2,714
Sales and marketing	2,387	2,395	4,803	4,847
General and administrative	584	497	1,144	1,049
Amortization of purchased intangible assets	118	97	240	196
Restructuring and other charges	13	3	72	205
Total operating expenses	4,554	4,331	9,142	9,011
OPERATING INCOME	2,789	2,734	5,440	4,944
Interest income	160	158	321	322
Interest expense	(147	) (150	) (295	) (298
Other income (loss), net	(22	) 7	(55	) 26
Interest and other income (loss), net	(9	) 15	(29	) 50
INCOME BEFORE PROVISION FOR (BENEFIT FROM) INCOME TAXES	2,780	2,749	5,411	4,994
Provision for (benefit from) income taxes	(363	) 567	176	1,035
NET INCOME	\$3,143	\$2,182	\$5,235	\$3,959
Net income per share:				
Basic	\$0.59	\$0.41	\$0.99	\$0.74
Diluted	\$0.59	\$0.40	\$0.98	\$0.73
Shares used in per-share calculation:				
Basic	5,318	5,368	5,310	5,381
Diluted	5,357	5,401	5,344	5,404
Cash dividends declared per common share	\$0.14	\$0.06	\$0.28	\$0.12
See Notes to Consolidated Financial Statements.				

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Net income	\$3,143	\$2,182	\$5,235	\$3,959
Available-for-sale investments:				
Change in net unrealized gains, net of tax benefit (expense) of \$(47) and \$(46) for the three and six months ended January 26, 2013, respectively, and \$2 and \$28 for the corresponding periods of fiscal 2012, respectively	69	10	73	(43)
Net gains reclassified into earnings, net of tax effects of \$5 and \$14 for the three and six months ended January 26, 2013, respectively, and \$14 and \$16 for the corresponding periods of fiscal 2012, respectively	(9)	(24)	(26)	(30)
	60	(14)	47	(73)
Cash flow hedging instruments:				
Change in unrealized gains and losses, net of tax expense of \$(1) for each of the three and six months ended January 26, 2013	2	(44)	68	(94)
Net (gains) losses reclassified into earnings	(8)	26	(3)	26
	(6)	(18)	65	(68)
Net change in cumulative translation adjustment and other, net of tax (expense) benefit of \$(5) and \$(15) for the three and six months ended January 26, 2013, respectively, and \$10 and \$31 for the corresponding periods of fiscal 2012, respectively	6	(106)	120	(317)
Other comprehensive income (loss)	60	(138)	232	(458)
Comprehensive income	3,203	2,044	5,467	3,501
Comprehensive loss attributable to noncontrolling interests	5	7	5	14
Comprehensive income attributable to Cisco Systems, Inc.	\$3,208	\$2,051	\$5,472	\$3,515

See Notes to Consolidated Financial Statements.

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

	Six Months Ended	
	January 26, 2013	January 28, 2012
Cash flows from operating activities:		
Net income	\$5,235	\$3,959
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and other	1,223	1,185
Share-based compensation expense	608	695
Provision for receivables	12	43
Deferred income taxes	148	29
Excess tax benefits from share-based compensation	(32)	(32)
Net losses (gains) on investments	14	(11)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	100	761
Inventories	194	(194)
Financing receivables	(403)	(551)
Other assets	(63)	(505)
Accounts payable	(17)	(78)
Income taxes, net	(1,444)	146
Accrued compensation	(161)	(508)
Deferred revenue	407	304
Other liabilities	(7)	191
Net cash provided by operating activities	5,814	5,434
Cash flows from investing activities:		
Purchases of investments	(14,234)	(17,810)
Proceeds from sales of investments	4,991	12,291
Proceeds from maturities of investments	8,652	4,039
Acquisition of property and equipment	(552)	(549)
Acquisition of businesses, net of cash and cash equivalents acquired	(6,035)	(109)
Purchases of investments in privately held companies	(116)	(231)
Return of investments in privately held companies	68	124
Other	30	160
Net cash used in investing activities	(7,196)	(2,085)
Cash flows from financing activities:		
Issuances of common stock	652	653
Repurchases of common stock - repurchase program	(645)	(2,210)
Shares repurchased for tax withholdings on vesting of restricted stock units	(212)	(145)
Short-term borrowings, maturities less than 90 days, net	4	17
Excess tax benefits from share-based compensation	32	32
Dividends paid	(1,487)	(644)
Other	86	(153)
Net cash used in financing activities	(1,570)	(2,450)
Net (decrease) increase in cash and cash equivalents	(2,952)	899
Cash and cash equivalents, beginning of period	9,799	7,662

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Cash and cash equivalents, end of period	\$6,847	\$8,561
Cash paid for:		
Interest	\$341	\$340
Income taxes	\$1,472	\$860
See Notes to Consolidated Financial Statements.		

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

Six Months Ended January 26, 2013	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders' Equity	Non-controlling Interests	Total Equity
BALANCE AT JULY 28, 2012	5,298	\$ 39,271	\$ 11,354	\$ 661	\$ 51,286	\$ 15	\$ 51,301
Net income			5,235		5,235		5,235
Other comprehensive income				237	237	(5)	232
Issuance of common stock	76	652			652		652
Repurchase of common stock - repurchase program	(40)	(298)	(455)		(753)		(753)
Shares repurchased for tax withholdings on vesting of restricted stock units	(11)	(212)			(212)		(212)
Cash dividends declared (\$0.28 per common share)			(1,487)		(1,487)		(1,487)
Tax effects from employee stock incentive plans		(97)			(97)		(97)
Share-based compensation expense		608			608		608
Purchase acquisitions and other		46			46		46
BALANCE AT JANUARY 26, 2013	5,323	\$ 39,970	\$ 14,647	\$ 898	\$ 55,515	\$ 10	\$ 55,525
Six Months Ended January 28, 2012	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Cisco Shareholders' Equity	Non-controlling Interests	Total Equity
BALANCE AT JULY 30, 2011	5,435	\$ 38,648	\$ 7,284	\$ 1,294	\$ 47,226	\$ 33	\$ 47,259
Net income			3,959		3,959		3,959
Other comprehensive loss				(444)	(444)	(14)	(458)
Issuance of common stock	78	653			653		653
Repurchase of common stock - repurchase program	(126)	(901)	(1,109)		(2,010)		(2,010)
Shares repurchased for tax withholdings on vesting of restricted stock units	(9)	(145)			(145)		(145)
Cash dividends declared (\$0.12 per common share)			(644)		(644)		(644)
Tax effects from employee stock incentive plans		(48)			(48)		(48)
Share-based compensation expense		695			695		695
Purchase acquisitions and other		4			4		4
BALANCE AT JANUARY 28, 2012	5,378	\$ 38,906	\$ 9,490	\$ 850	\$ 49,246	\$ 19	\$ 49,265

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In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of January 26, 2013, the Company's Board of Directors had authorized an aggregate repurchase of up to \$82 billion of common stock under this program with no termination date. For additional information regarding stock repurchases, see Note 13 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impacts on Cisco shareholders' equity are summarized in the following table (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Total Cisco Shareholders' Equity
Repurchases of common stock under the repurchase program	3,780	\$ 17,339	\$ 59,547	\$ 76,886
See Notes to Consolidated Financial Statements.				

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

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

The accompanying financial data as of January 26, 2013 and for the three and six months ended January 26, 2013 and January 28, 2012 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted pursuant to such rules and regulations. The July 28, 2012 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended July 28, 2012.

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

In the opinion of management, all adjustments (which include normal recurring adjustments, except as disclosed herein) necessary to present fairly the statement of financial position as of January 26, 2013; the results of operations for the three and six months ended January 26, 2013 and January 28, 2012; and the statements of cash flows and equity for the six months ended January 26, 2013 and January 28, 2012, as applicable, have been made. The results of operations for the three and six months ended January 26, 2013 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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

2. Recent Accounting Pronouncements

(a) New Accounting Updates Recently Adopted

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

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

(b)Recent Accounting Standards or Updates Not Yet Effective

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

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

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

In February 2013, the FASB issued an accounting standard update to require reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2014, at which time the Company will include the required disclosures.

3. Business Combinations

(a) Acquisition Summary

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

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

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

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

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

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

	Fair Value
Cash and cash equivalents	\$98
Accounts receivable, net	199
Other tangible assets	268
Goodwill	3,444
Purchased intangible assets	1,746
Deferred tax liabilities, net	(378)
Liabilities assumed	(372)

Total purchase consideration

\$5,005

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company completed seven additional business combinations during the six months ended January 26, 2013. A summary of the allocation of the total purchase consideration is presented as follows (in millions):

	Purchase Consideration	Net Liabilities Assumed	Purchased Intangible Assets	Goodwill
Meraki Inc.	\$974	\$(59)	) \$289	\$744
All others (six in total)	233	(15)	) 72	176
Total other acquisitions	\$1,207	\$(74)	) \$361	\$920

The Company acquired privately held Meraki Inc. ("Meraki") in the second quarter of fiscal 2013. Meraki offers mid-market customers on-premise networking solutions centrally managed from the cloud. With its acquisition of Meraki, the Company intends to address the shift to cloud networking as a key part of the Company's overall strategy to accelerate the adoption of software-based business models that provide new consumption options for customers and revenue opportunities for partners. The Company has included sales from the Meraki acquisition, subsequent to the acquisition date, in its Wireless product category.

The total purchase consideration related to the Company's business combinations completed during the six months ended January 26, 2013 consisted of cash consideration, repayment of debt, and vested share-based awards assumed. The total cash and cash equivalents acquired from these business combinations were approximately \$131 million.

(b) Other Acquisition/Divestiture Information

Total transaction costs related to the Company's business combination activities were \$17 million and \$2 million for the six months ended January 26, 2013 and January 28, 2012, respectively. These transaction costs were expensed as incurred as general and administrative ("G&A") expenses in the Consolidated Statements of Operations.

The goodwill generated from the Company's business combinations completed during the six months ended January 26, 2013 is primarily related to expected synergies. The goodwill is generally not deductible for U.S. federal income tax purposes.

The Consolidated Financial Statements include the operating results of each business combination from the date of acquisition. Pro forma results of operations for the acquisitions completed during the six months ended January 26, 2013 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company's financial results.

During the second quarter of fiscal 2013, the Company agreed to sell its Linksys product line to a third party. The financial statement impact of the Company's Linksys product line was not material for any of the periods presented. This transaction is expected to close during the third quarter of fiscal 2013, subject to customary closing conditions.

(c) Pending Acquisition of Intucell

On January 23, 2013, the Company announced that it had entered into a definitive agreement to acquire privately held Intucell Ltd. ("Intucell"). Intucell provides advanced self-optimizing network software for mobile carriers. The acquisition of Intucell enhances the Company's commitment to global service providers by adding a critical network intelligence layer to manage and optimize spectrum, coverage and capacity, and ultimately the quality of the mobile experience.

Under the agreement, the Company has agreed to pay approximately \$475 million in cash and retention-based incentives to acquire Intucell. The acquisition is expected to close in the third quarter of fiscal 2013 and is subject to customary closing conditions, including regulatory review.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

4. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the goodwill allocated to the Company's reportable segments as of and during the six months ended January 26, 2013 (in millions):

	Balance at July 28, 2012	NDS Acquisition	Other Acquisitions	Other	Balance at January 26, 2013
Americas	\$11,755	\$1,230	\$520	\$(1)	\$13,504
EMEA	3,287	1,327	266	—	4,880
APJC	1,956	887	134	—	2,977
Total	\$16,998	\$3,444	\$920	\$(1)	\$21,361

In the preceding table, the column entitled "Other" primarily relates to 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 six months ended January 26, 2013 (in millions, except years):

	FINITE LIVES		CUSTOMER RELATIONSHIPS		OTHER		INDEFINITE LIVES TOTAL	
	TECHNOLOGY	Amount	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount	Amount
NDS Group Limited	6.4	\$807	6.7	\$818	7.4	\$27	\$94	\$1,746
Meraki Inc.	8.0	259	6.0	30	—	—	—	289
All other acquisitions	4.7	45	5.6	12	7.0	1	14	72
Total		\$1,111		\$860		\$28	\$108	\$2,107

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

January 26, 2013	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,400	\$(1,154)	\$2,246
Customer relationships	3,118	(1,890)	1,228
Other	67	(41)	26
Total purchased intangible assets with finite lives	6,585	(3,085)	3,500
In-process research and development, with indefinite lives	42	—	42
Total	\$6,627	\$(3,085)	\$3,542
July 28, 2012	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$2,267	\$(908)	\$1,359
Customer relationships	2,261	(1,669)	592
Other	49	(41)	8
Total	\$4,577	\$(2,618)	\$1,959

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

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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		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Amortization of purchased intangible assets:				
Cost of sales	\$ 145	\$ 99	\$ 288	\$ 195
Operating expenses	118	97	240	196
Total	\$ 263	\$ 196	\$ 528	\$ 391

There were no impairment charges related to purchased intangible assets during the periods presented.

The estimated future amortization expense of purchased intangible assets with finite lives as of January 26, 2013 is as follows (in millions):

Fiscal Year	Amount
2013 (remaining six months)	\$467
2014	840
2015	760
2016	533
2017	380
Thereafter	520
Total	\$3,500

5. Restructuring and Other Charges

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

Pursuant to the restructuring that the Company announced in July 2011, the Company has incurred cumulative charges of approximately \$1.1 billion (included as part of the charges discussed below). The Company has substantially completed the July 2011 restructuring and does not expect significant remaining charges related to these actions. The following table summarizes the activities related to the restructuring and other charges pursuant to the Company's July 2011 announcement related to the realignment and restructuring of the Company's business as well as certain consumer product lines as announced during April 2011 (in millions):

	Voluntary Early Retirement Program	Employee Severance	Goodwill and Intangible Assets	Other	Total
Gross charges in fiscal 2011	\$ 453	\$ 247	\$ 71	\$ 28	\$ 799
Cash payments	(436)	(13)	—	—	(449)
Non-cash items	—	—	(71)	(17)	(88)
BALANCE AT JULY 30, 2011	\$ 17	\$ 234	\$ —	\$ 11	\$ 262
Gross charges in fiscal 2012	—	299	—	54	353
Change in estimate related to fiscal 2011 charges	—	(49)	—	—	(49)
Cash payments	(17)	(401)	—	(18)	(436)
Non-cash items	—	—	—	(20)	(20)

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BALANCE AT JULY 28, 2012	\$—	\$83	\$—	\$27	\$110	
Charges in fiscal 2013	—	77	—	(5) 72	
Cash payments	—	(139) —	(10) (149)
Non-cash items	—	—	—	(3) (3)
BALANCE AT JANUARY 26, 2013	\$—	\$21	\$—	\$9	\$30	

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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):

	January 26, 2013	July 28, 2012
Inventories:		
Raw materials	\$ 113	\$ 127
Work in process	24	35
Finished goods:		
Distributor inventory and deferred cost of sales	648	630
Manufactured finished goods	498	597
Total finished goods	1,146	1,227
Service-related spares	248	213
Demonstration systems	43	61
 Total	 \$ 1,574	 \$ 1,663
 Property and equipment, net:		
Land, buildings, and building and leasehold improvements	\$4,491	\$4,363
Computer equipment and related software	1,455	1,469
Production, engineering, and other equipment	5,642	5,364
Operating lease assets ⁽¹⁾	304	300
Furniture and fixtures	493	487
	12,385	11,983
Less accumulated depreciation and amortization ⁽¹⁾	(8,982	) (8,581
Total	\$3,403	\$3,402
 Other assets:		
Deferred tax assets	\$ 1,807	\$ 2,270
Investments in privately held companies	869	858
Other	834	754
Total	\$3,510	\$3,882
 Deferred revenue:		
Service	\$9,055	\$9,173
Product:		
Unrecognized revenue on product shipments and other deferred revenue	3,309	2,975
Cash receipts related to unrecognized revenue from two-tier distributors	957	732
Total product deferred revenue	4,266	3,707
Total	\$ 13,321	\$ 12,880
Reported as:		
Current	\$9,108	\$8,852
Noncurrent	4,213	4,028

⁽¹⁾ Accumulated depreciation related to operating lease assets was \$186 and \$181 as of January 26, 2013 and July 28, 2012, respectively.

Total	\$13,321	\$12,880
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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. Loan receivables represent financing arrangements related to the sale of the Company's products and services, which may include additional funding for other costs associated with network installation and integration of the Company's products and services. 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 advanced services, as well as 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):

	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total Financing Receivables
January 26, 2013				
Gross	\$3,717	\$1,785	\$ 2,863	\$8,365
Unearned income	(273	) —	—	(273
Allowance for credit loss	(247	) (101	) (13	) (361
Total, net	\$3,197	\$1,684	\$ 2,850	\$7,731
Reported as:				
Current	\$1,349	\$960	\$ 1,585	\$3,894
Noncurrent	1,848	724	1,265	3,837
Total, net	\$3,197	\$1,684	\$ 2,850	\$7,731
July 28, 2012				
Gross	\$3,429	\$1,796	\$ 2,651	\$7,876
Unearned income	(250	) —	—	(250
Allowance for credit loss	(247	) (122	) (11	) (380
Total, net	\$2,932	\$1,674	\$ 2,640	\$7,246
Reported as:				
Current	\$1,200	\$968	\$ 1,493	\$3,661
Noncurrent	1,732	706	1,147	3,585
Total, net	\$2,932	\$1,674	\$ 2,640	\$7,246

As of January 26, 2013 and July 28, 2012, the deferred service revenue related to the financed service contracts and other was \$1,943 million and \$1,838 million, respectively.

Contractual maturities of the gross lease receivables at January 26, 2013 are summarized as follows (in millions):

Fiscal Year	Amount
2013 (remaining six months)	\$878
2014	1,345
2015	863
2016	437
2017	194
Total	\$3,717

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 as of January 26, 2013 and July 28, 2012 are summarized as follows (in millions):

	INTERNAL CREDIT RISK RATING			Total	Residual Value	Gross Receivables, Net of Unearned Income
	1 to 4	5 to 6	7 and Higher			
January 26, 2013						
Lease receivables	\$1,607	\$1,505	\$58	\$3,170	\$274	\$3,444
Loan receivables	882	857	46	1,785	—	1,785
Financed service contracts and other	1,579	1,179	105	2,863	—	2,863
Total	\$4,068	\$3,541	\$209	\$7,818	\$274	\$8,092
	INTERNAL CREDIT RISK RATING					
	1 to 4	5 to 6	7 and Higher	Total	Residual Value	Gross Receivables, Net of Unearned Income
July 28, 2012						
Lease receivables	\$1,532	\$1,342	\$31	\$2,905	\$274	\$3,179
Loan receivables	831	921	44	1,796	—	1,796
Financed service contracts and other	1,552	1,030	69	2,651	—	2,651
Total	\$3,915	\$3,293	\$144	\$7,352	\$274	\$7,626

The Company determines the adequacy of its allowance for credit loss by assessing the risks and losses inherent in its financing receivables by portfolio segment. The portfolio segment is based on the types of financing offered by the Company to its customers: lease receivables, loan receivables, and financed service contracts and other.

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.

In circumstances when collectibility 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 January 26, 2013 and July 28, 2012 were \$2,429 million and \$2,387 million, respectively, and they were associated with financing receivables (net of unearned income) of \$8,092 million and \$7,626 million as of their respective period ends. The losses that the Company has incurred historically, including in the periods presented with respect to its financing receivables, have been immaterial and consistent with the performance of an investment-grade portfolio. The Company did not modify any financing receivables during the periods presented. The following tables present the aging analysis of financing receivables as of January 26, 2013 and July 28, 2012 (in millions):

	DAYS PAST DUE (INCLUDES BILLED AND UNBILLED)				Total Past Due	Current	Gross Receivables, Net of Unearned Income	Non-Accrued Financing Receivables	Impaired Financing Receivables
	31-60	61-90	91+						
January 26, 2013									
Lease receivables	\$182	\$34	\$230	\$446	\$2,998	\$3,444	\$49	\$33	

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Loan receivables	12	3	11	26	1,759	1,785	32	32
Financed service contracts and other	305	37	251	593	2,270	2,863	21	13
Total	\$499	\$74	\$492	\$1,065	\$7,027	\$8,092	\$102	\$78

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

July 28, 2012	DAYS PAST DUE (INCLUDES BILLED AND UNBILLED)			Total Past Due	Current	Gross Receivables, Non-Accrued Impaired		
	31-60	61-90	91+			Net of Unearned Income	Financing Receivables	Financing Receivables
Lease receivables	\$151	\$69	\$173	\$393	\$2,786	\$3,179	\$23	\$14
Loan receivables	10	8	11	29	1,767	1,796	4	4
Financed service contracts and other	89	68	392	549	2,102	2,651	18	10
Total	\$250	\$145	\$576	\$971	\$6,655	\$7,626	\$45	\$28

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 lease receivables, loan receivables, and financed service contracts and other were, respectively, \$179 million, \$6 million, and \$199 million as of January 26, 2013; and were, respectively, \$139 million, \$3 million, and \$313 million as of July 28, 2012.

As of January 26, 2013, the Company had financing receivables of \$82 million, net of unbilled or current receivables from the same contract, that were in the category for 91 days plus past due but remained on accrual status. Such balance was \$109 million as of July 28, 2012. A financing receivable may be placed on nonaccrual status earlier if, in management's opinion, a timely collection of the full principal and interest becomes uncertain.

(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			
	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Allowance for credit loss as of July 28, 2012	\$247	\$122	\$11	\$380
Provisions	(2)	(10)	1	(11)
Write-offs net of recoveries	—	—	—	—
Foreign exchange and other	3	2	—	5
Allowance for credit loss as of October 27, 2012	248	114	12	374
Provisions	(1)	(14)	2	(13)
Write-offs net of recoveries	—	—	—	—
Foreign exchange and other	—	1	(1)	—
Allowance for credit loss as of January 26, 2013	\$247	\$101	\$13	\$361
Gross receivables as of January 26, 2013, net of unearned income	\$3,444	\$1,785	\$2,863	\$8,092
	CREDIT LOSS ALLOWANCES			
	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
Write-offs net of recoveries	—	—	—	—

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Foreign exchange and other	(6) (5) —	(11)
Allowance for credit loss as of October 29, 2011	233	103	29	365	
Provisions	18	4	(18	) 4	
Write-offs net of recoveries	—	—	—	—	
Foreign exchange and other	(1	) 3	(2) —	
Allowance for credit loss as of January 28, 2012	\$250	\$110	\$ 9	\$369	
Gross receivables as of January 28, 2012, net of unearned income	\$3,049	\$1,673	\$ 2,666	\$7,388	

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company assesses the allowance for credit loss related to financing receivables on either an individual or a collective basis. The Company considers 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 the Company's 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.

Typically, the Company also considers receivables with a risk rating of 8 or higher to be impaired and will include them in the individual assessment for allowance. Financing receivables that were individually evaluated for impairment during the periods presented were not material and therefore are not presented separately in the preceding tables.

The Company evaluates the remainder of its financing receivables portfolio for impairment on a collective basis and records an allowance for credit loss at the portfolio segment level. When evaluating the financing receivables on a collective basis, the Company uses expected default frequency rates published by a major third-party credit-rating agency as well as its own historical loss rate in the event of default, while also systematically giving effect to economic conditions, concentration of risk, and correlation.

(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 \$5.8 billion and \$5.4 billion for the three months ended January 26, 2013 and January 28, 2012, respectively. The volume of channel partner financing was \$11.4 billion and \$10.7 billion for the six months ended January 26, 2013 and January 28, 2012, respectively. The balance of the channel partner financing subject to guarantees was \$1.4 billion and \$1.2 billion as of January 26, 2013 and July 28, 2012, respectively.

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, which typically have terms of up to three years. The volume of financing provided by third parties for leases and loans as to which the Company had provided guarantees was \$55 million and \$60 million for the three months ended January 26, 2013 and January 28, 2012, respectively, and was \$99 million and \$95 million for the six months ended January 26, 2013 and January 28, 2012, respectively.

Financing Guarantee Summary The aggregate amounts of financing guarantees outstanding at January 26, 2013 and July 28, 2012, 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, 2013	July 28, 2012
Maximum potential future payments relating to financing guarantees:		
Channel partner	\$491	\$277
End user	254	232
Total	\$745	\$509
Deferred revenue associated with financing guarantees:		
Channel partner	\$(267)	\$(193)

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End user	(217) (200)
Total	\$(484) \$(393)
Maximum potential future payments relating to financing guarantees, net of associated deferred revenue	\$261	\$116	

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. Investments

(a) Summary of Available-for-Sale Investments

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

January 26, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
U.S. government securities	\$25,147	\$31	\$(1)	\$25,177
U.S. government agency securities	3,776	14	—	3,790
Non-U.S. government and agency securities	1,329	7	—	1,336
Corporate debt securities	7,021	99	(2)	7,118
Total fixed income securities	37,273	151	(3)	37,421
Publicly traded equity securities	1,484	628	(4)	2,108
Total	\$38,757	\$779	\$(7)	\$39,529
July 28, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
U.S. government securities	\$24,201	\$41	\$(1)	\$24,241
U.S. government agency securities	5,367	21	—	5,388
Non-U.S. government and agency securities	1,629	9	—	1,638
Corporate debt securities	5,959	74	(3)	6,030
Total fixed income securities	37,156	145	(4)	37,297
Publicly traded equity securities	1,107	524	(11)	1,620
Total	\$38,263	\$669	\$(15)	\$38,917

U.S. government agency securities include corporate debt securities that are guaranteed by the Federal Deposit Insurance Corporation, while non-U.S. government and agency securities include 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 gross realized gains and gross realized losses related to the Company's available-for-sale investments (in millions):

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Gross realized gains	\$191	\$188	\$263	\$424
Gross realized losses	(178)	(151)	(223)	(378)
Total	\$13	\$37	\$40	\$46

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Net gains (losses) on investments in publicly traded equity securities	\$4	\$31	\$14	\$15
Net gains on investments in fixed income securities	9	6	26	31
Total	\$13	\$37	\$40	\$46

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

There were no impairment charges on available-for-sale investments for the periods presented.

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 January 26, 2013 and July 28, 2012 (in millions):

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 12 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
January 26, 2013						
Fixed income securities:						
U.S. government securities	\$2,617	\$(1)	\$ —	\$ —	\$2,617	\$(1)
Corporate debt securities	1,014	(2)	—	—	1,014	(2)
Total fixed income securities	3,631	(3)	—	—	3,631	(3)
Publicly traded equity securities	36	(4)	—	—	36	(4)
Total	\$3,667	\$(7)	\$ —	\$ —	\$3,667	\$(7)

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 12 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
July 28, 2012						
Fixed income securities:						
U.S. government securities	\$5,357	\$(1)	\$ —	\$ —	\$5,357	\$(1)
Corporate debt securities	603	(3)	14	—	617	(3)
Total fixed income securities	5,960	(4)	14	—	5,974	(4)
Publicly traded equity securities	167	(8)	20	(3)	187	(11)
Total	\$6,127	\$(12)	\$ 34	\$(3)	\$6,161	\$(15)

As of January 26, 2013, for fixed income securities that were in unrealized loss positions, 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 January 26, 2013, 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 and six months ended January 26, 2013.

The Company has evaluated its publicly traded equity securities as of January 26, 2013 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 January 26, 2013 (in millions):

	Amortized Cost	Fair Value
Less than 1 year	\$16,215	\$16,234
Due in 1 to 2 years	10,710	10,752
Due in 2 to 5 years	10,230	10,310

Due after 5 years	118	125
Total	\$37,273	\$37,421

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

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(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 daily balance of securities lending for the six months ended January 26, 2013 and January 28, 2012 was \$0.8 billion and \$0.4 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 in the form of 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 collateral losses. The Company did not experience any losses in connection with the secured lending of securities during the periods presented. As of January 26, 2013 and July 28, 2012, 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 either recorded or disclosed at fair value, the Company considers the principal or most advantageous market in which it would transact, and it also 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 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.

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 as of January 26, 2013 and July 28, 2012 were as follows (in millions):

	JANUARY 26, 2013				JULY 28, 2012			
	FAIR VALUE MEASUREMENTS				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	\$4,513	\$—	\$—	\$4,513	\$2,506	\$—	\$—	\$2,506
Available-for-sale investments:								
U.S. government securities	—	25,177	—	25,177	—	24,241	—	24,241
U.S. government agency securities	—	3,790	—	3,790	—	5,388	—	5,388
Non-U.S. government and agency securities	—	1,336	—	1,336	—	1,638	—	1,638
Corporate debt securities	—	7,118	—	7,118	—	6,030	—	6,030
Publicly traded equity securities	2,108	—	—	2,108	1,620	—	—	1,620
Derivative assets	—	244	—	244	—	263	1	264
Total	\$6,621	\$37,665	\$—	\$44,286	\$4,126	\$37,560	\$1	\$41,687
Liabilities:								
Derivative liabilities	\$—	\$57	\$—	\$57	\$—	\$42	\$—	\$42
Total	\$—	\$57	\$—	\$57	\$—	\$42	\$—	\$42

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 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.

There was no material activity related to assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended January 26, 2013.

The following table presents a reconciliation of all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended January 28, 2012 (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 (loss), net	3	—	3
Included in other comprehensive income (loss)	(3	) —	(3
Sales and maturities	(14) (1) (15
Transfer into Level 2	(107) —	(107

Balance at January 28, 2012	\$—	\$1	\$1
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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company's asset-backed securities were reclassified from Level 3 to Level 2 at January 28, 2012, the end of the Company's second quarter for fiscal 2012, as circumstances indicated an increase in market activity and related observable market data was available for these financial assets.

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

The following table presents 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):

	January 26, 2013		January 28, 2012	
	Net Carrying Value as of End of Period	Total Losses for the Three Months Ended	Total Losses for the Six Months Ended	
Investments in privately held companies	\$60	\$ (8)	\$ (18)	
	Net Carrying Value as of End of Period	Total Gains (Losses) for the Three Months Ended	Total Gains (Losses) for the Six Months Ended	
Investments in privately held companies	\$6	\$ (1)	\$ (2)	
Property held for sale	\$39	(27)	(116)	
Gains on assets no longer held at period end		14	14	
Total losses for nonrecurring measurements		\$ (14)	\$ (104)	

The assets in the preceding tables were measured at fair value due to events or circumstances the Company identified as having significant impact on their fair value during the respective periods. To arrive at the valuation of these assets, the Company considers any significant changes in the financial metrics and economic variables, and also uses third-party valuation reports to assist in the valuation as necessary. These assets were classified as Level 3 assets because the Company used unobservable inputs to value them.

The fair value measurement of the impaired investments was classified as Level 3 because significant unobservable inputs were used in the valuation due to the absence of quoted market prices and inherent lack of liquidity. Significant unobservable inputs, which included financial metrics of comparable private and public companies, financial condition and near-term prospects of the investees, recent financing activities of the investees, and the investees' capital structure as well as other economic variables, reflected the assumptions market participants would use in pricing these assets. The impairment charges, representing the difference between the cost and the fair value as a result of the evaluation, were recorded to other income (loss), net.

The property held for sale represents land and buildings which met the criteria to be classified as held for sale. 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 charges 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, were included in G&A expenses.

(d) Other Fair Value Disclosures

The carrying value of the Company's investments in privately held companies that were accounted for under the cost method was \$239 million and \$249 million as of January 26, 2013 and July 28, 2012, respectively. It was not practicable to estimate the fair value of this portfolio.

The fair value of the Company's short-term loan receivables and financed service contracts approximates their carrying value due to their short duration. The aggregate carrying value of the Company's long-term loan receivables and financed service contracts and other as of January 26, 2013 and July 28, 2012 was \$2.0 billion and \$1.9 billion, respectively. The estimated fair value of the Company's long-term loan receivables and financed service contracts and other approximates their carrying value. The Company uses significant unobservable inputs in determining discounted

cash flows to estimate the fair value of its long-term loan receivables and financed service contracts, and therefore they are categorized as Level 3.

As of January 26, 2013, the fair value of the Company's long-term debt was \$18.3 billion with a carrying amount of \$16.3 billion. This compares to a fair value of \$18.8 billion and a carrying amount of \$16.3 billion as of July 28, 2012. The fair value of the 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.

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

10. Borrowings

(a) Short-Term Debt

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

	January 26, 2013		July 28, 2012	
	Amount	Weighted-Average Interest Rate	Amount	Weighted-Average Interest Rate
Other notes and borrowings	\$37	9.60 %	\$31	6.72 %

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 uses the proceeds from the issuance of commercial paper notes for general corporate purposes. The Company had no commercial paper notes outstanding as of each of January 26, 2013 and July 28, 2012.

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 January 26, 2013, 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):

	January 26, 2013		July 28, 2012	
	Amount	Effective Rate	Amount	Effective Rate
Senior Notes:				
Floating-rate notes, due 2014	\$1,250	0.57%	\$1,250	0.81%
1.625% fixed-rate notes, due 2014	2,000	0.68%	2,000	0.84%
2.90% fixed-rate notes, due 2014	500	3.11%	500	3.11%
5.50% fixed-rate notes, due 2016	3,000	3.08%	3,000	3.16%
3.15% fixed-rate notes, due 2017	750	0.87%	750	1.03%
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	
Other long-term debt	10	0.19%	10	0.19%
Unaccreted discount	(67)	)	(70))
Hedge accounting fair value adjustments	311		357	
Total long-term debt	\$16,254		\$16,297	

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 of its 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 to the Consolidated Financial Statements.

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. 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.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The senior notes rank at par with the commercial paper notes that may be issued in the future pursuant to the Company's short-term debt financing program, as discussed above under "Short-Term Debt." As of January 26, 2013, the Company was in compliance with all debt covenants.

Future principal payments for long-term debt as of January 26, 2013 are summarized as follows (in millions):

Fiscal Year	Amount
2013 (remaining six months)	\$—
2014	3,260
2015	500
2016	3,000
2017	750
Thereafter	8,500
Total	\$16,010

(c) Credit Facility

On February 17, 2012, the Company 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 February 17, 2017. 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%, Bank of America's "prime rate" as announced from time to time, or one-month LIBOR plus 1.00%, or (ii) LIBOR plus a margin that is based on the Company's senior debt credit ratings as published by Standard & Poor's Financial Services, LLC and Moody's Investors Service, Inc. The credit agreement requires the Company to comply with certain covenants, including that it maintains an interest coverage ratio as defined in the agreement. As of January 26, 2013, the Company was in compliance with all such required covenants, and the Company had not borrowed any funds under the credit facility.

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 \$2.0 billion and/or extend the expiration date of the credit facility by up to two additional years, or up to February 17, 2019.

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.

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

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	January 26, 2013	July 28, 2012	Balance Sheet Line Item	January 26, 2013	July 28, 2012
Derivatives designated as hedging instruments:						
Foreign currency derivatives	Other current assets	\$ 34	\$ 24	Other current liabilities	\$ 2	\$ 26
Interest rate derivatives	Other assets	194	223	Other long-term liabilities	—	—
Equity derivatives	Other current assets	—	—	Other current liabilities	43	4
Total		228	247		45	30
Derivatives not designated as hedging instruments:						
Foreign currency derivatives	Other current assets	16	16	Other current liabilities	12	12
Equity derivatives	Other assets	—	1	Other long-term liabilities	—	—
Total		16	17		12	12
Total		\$ 244	\$ 264		\$ 57	\$ 42

The effects of the Company's 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)		
Derivatives designated as cash flow hedging instruments:	January 26, 2013	January 28, 2012	Line Item in Statements of Operations	January 26, 2013	January 28, 2012
Foreign currency derivatives	\$ 3	\$(44)	Operating expenses	\$ 6	\$(22)
			Cost of sales - service	2	(4)
Total	\$ 3	\$(44)		\$ 8	\$(26)

Derivatives designated as net investment hedging instruments:

GAINS (LOSSES) RECOGNIZED IN OCI ON DERIVATIVES FOR THE SIX MONTHS ENDED (EFFECTIVE PORTION)			GAINS (LOSSES) RECLASSIFIED FROM AOCI INTO INCOME FOR THE SIX MONTHS ENDED (EFFECTIVE PORTION)		
Derivatives designated as cash flow hedging instruments:	January 26, 2013	January 28, 2012	Line Item in Statements of Operations	January 26, 2013	January 28, 2012
Foreign currency derivatives	\$—	\$(2)	Other income (loss), net	\$—	\$—
Foreign currency derivatives	\$ 69	\$(94)	Operating expenses	\$ 2	\$(22)
			Cost of sales - service	1	(4)
Total	\$ 69	\$(94)		\$ 3	\$(26)

Derivatives designated as net investment hedging instruments:

Foreign currency derivatives	\$(24)	\$(6)	Other income (loss), net	\$—	\$—
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During the three and six months ended January 26, 2013 and January 28, 2012, the amounts recognized in earnings on derivative instruments designated as cash flow hedges and net investment 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 January 26, 2013, the Company estimates that approximately \$25 million of net derivative gains related to its cash flow hedges included in accumulated other comprehensive income ("AOCI") will be reclassified into earnings within the next 12 months.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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		GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE THREE MONTHS ENDED	
		January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Equity derivatives	Other income (loss), net	\$ (39)	\$ —	\$ 39	\$ —
Interest rate derivatives	Interest expense	(11)	41	11	(42)
Total		\$ (50)	\$ 41	\$ 50	\$ (42)

Derivatives Designated as Fair Value Hedging Instruments	Line Item in Statements of Operations	GAINS (LOSSES) ON DERIVATIVES INSTRUMENTS FOR THE SIX MONTHS ENDED		GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE SIX MONTHS ENDED	
		January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Equity derivatives	Other income (loss), net	\$ (42)	\$ —	\$ 42	\$ —
Interest rate derivatives	Interest expense	(29)	76	29	(78)
Total		\$ (71)	\$ 76	\$ 71	\$ (78)

The Company did not exclude from the assessment of hedge effectiveness any component of the changes in fair value of the derivative instruments designated as fair value hedges.

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, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Foreign currency derivatives	Other income (loss), net	\$ (41)	\$ (88)	\$ 12	\$ (145)
Total return swaps - deferred compensation	Cost of sales	—	3	—	3
	Operating expenses	19	10	33	(10)
Equity derivatives	Other income (loss), net	3	(18)	12	(11)
Total		\$ (19)	\$ (93)	\$ 57	\$ (163)

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

	January 26, 2013	July 28, 2012
Derivatives designated as hedging instruments:		
Foreign currency derivatives - cash flow hedges	\$1,646	\$2,910
Interest rate derivatives	4,250	4,250
Net investment hedging instruments	325	468
Equity derivatives	629	272

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Derivatives not designated as hedging instruments:

Foreign currency derivatives	4,231	6,241
Total return swaps-deferred compensation	324	269
Total	\$11,405	\$14,410

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(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 forecasted foreign currency 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 periods presented, the Company did not discontinue any cash flow hedges for which it was probable that a forecasted transaction would not occur.

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 (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.

The Company hedges certain net investments in its foreign operations with forward contracts to reduce the effects of foreign currency fluctuations on the Company's net investment in those foreign subsidiaries. These derivative instruments generally have maturities of up to six months.

(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 January 26, 2013 and July 28, 2012, 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 are also included in other income (loss), net.

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.

(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 January 26, 2013 and July 28, 2012.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Commitments and Contingencies

(a) Operating Leases

The Company leases office space in many U.S. locations. Outside the United States, larger leased sites include sites in Australia, China, France, 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 January 26, 2013 are as follows (in millions):

Fiscal Year	Amount
2013 (remaining six months)	\$ 182
2014	281
2015	237
2016	120
2017	83
Thereafter	226
Total	\$ 1,129

(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 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 January 26, 2013 and July 28, 2012, the Company had total purchase commitments for inventory of \$3,824 million and \$3,869 million, 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 January 26, 2013 and July 28, 2012, the liability for these purchase commitments was \$169 million and \$193 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 \$23 million and \$14 million during the three months ended January 26, 2013 and January 28, 2012, respectively, and \$35 million and \$28 million during the six months ended January 26, 2013 and January 28, 2012, respectively. As of January 26, 2013, the Company estimated that future compensation expense and contingent consideration of up to \$1.1 billion may be required to be recognized pursuant to the applicable business combination and asset purchase agreements, which included a maximum potential \$863 million in milestone payments related to Insieme as more fully discussed in the subsection entitled "Insieme" within section (d) immediately below.

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 \$133 million and \$120 million as of January 26, 2013 and July 28, 2012, respectively.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(d) Variable Interest Entities

VCE Joint Venture VCE is a joint venture that the Company formed in fiscal 2010 with EMC Corporation ("EMC"), with investments from VMware, Inc. ("VMware") and Intel Corporation. VCE helps organizations leverage best-in-class technologies and disciplines from Cisco, EMC, and VMware to enable the transformation to cloud computing.

As of January 26, 2013, the Company's cumulative gross investment in VCE was approximately \$457 million, inclusive of accrued interest, and its ownership percentage was approximately 35%.

The Company accounts for its investment in VCE under the equity method, and its portion of VCE's net loss is recognized in other income (loss), net. The Company's consolidated share of VCE's losses, based upon its portion of the overall funding, was approximately 36.8% for each of the three and six months ended January 26, 2013 and January 28, 2012. As of January 26, 2013, the Company has recorded cumulative losses from VCE of \$325 million since inception, of which losses of \$44 million and \$55 million were recorded for the three months ended January 26, 2013 and January 28, 2012, respectively, and a loss of \$86 million was recorded for each of the six months ended January 26, 2013 and January 28, 2012. The Company's carrying value in VCE as of January 26, 2013 of \$132 million is recorded in other assets.

Over the next 12 months, as VCE scales its operations, the Company expects that it will make additional investments in VCE and may incur additional losses proportionate with the Company's share ownership.

From time to time, EMC and Cisco may enter into guarantee agreements on behalf of VCE to indemnify third parties, such as customers, for monetary damages. Such guarantees were not material as of January 26, 2013.

Insieme In the third quarter of fiscal 2012, the Company made an investment in Insieme, an early stage company focused on research and development in the data center market. As set forth in the agreement between the Company and Insieme, this investment includes \$100 million of funding and a license to certain of the Company's technology. In addition, pursuant to a November 2012 amendment to the agreement between the Company and Insieme, the Company agreed to invest an additional \$35 million in Insieme upon the satisfaction of certain conditions. As of January 26, 2013, the Company owned approximately 87% of Insieme as a result of these investments and has consolidated the results of Insieme in its Consolidated Financial Statements.

The net loss attributable to the noncontrolling interests was not presented separately in the Consolidated Statements of Operations due to the amount being immaterial. In connection with this investment, the Company and Insieme have entered into a put/call option agreement that provides the Company with the right to purchase the remaining interests in Insieme. In addition, the noncontrolling interest holders can require the Company to purchase their shares upon the occurrence of certain events. If the Company acquires the remaining interests of Insieme, the noncontrolling interest holders are eligible to receive two milestone payments, which will be determined using agreed-upon formulas based on revenue for certain of Insieme's products. The Company will begin recognizing the amounts due under the milestone payments when it is determined that such payments are probable of being earned, which the Company expects may be in fiscal 2014. When such a determination is made, the milestone payments will then be recorded as compensation expense by the Company based on an estimate of the fair value of the amounts probable of being earned, pursuant to a vesting schedule. Subsequent changes to the fair value of the amounts probable of being earned and the continued vesting will result in adjustments to the recorded compensation expense. The maximum amount that could be recorded as compensation expense by the Company is approximately \$863 million. This maximum amount was increased from the previous maximum of \$750 million due to a November 2012 amendment to the agreement, as the parties recognized that higher staffing levels may be necessary to perform additional product development. The milestone payments, if earned, are expected to be paid primarily during fiscal 2016 and fiscal 2017.

Other Variable Interest Entities In the ordinary course of business, the Company has investments in other privately held companies and provides financing to certain customers. These other privately held companies and customers may be considered to be variable interest entities. The Company evaluates on an ongoing basis its investments in these other privately held companies and its customer financings and has determined that as of January 26, 2013 there were

no other variable interest entities required to be consolidated in the Company's Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(e) Product Warranties and Guarantees

The following table summarizes the activity related to product warranty liability during the six months ended January 26, 2013 and January 28, 2012 (in millions):

	Six Months Ended	
	January 26, 2013	January 28, 2012
Balance at beginning of period	\$415	\$342
Provision for warranties issued	319	331
Payments	(310	) (266
Balance at end of period	\$424	\$407

The Company accrues for warranty costs as part of its cost of sales based on associated material product costs, labor costs for technical support staff, and associated overhead. The Company's products are generally covered by a warranty for periods ranging from 90 days to five years, and for some products the Company provides a limited lifetime warranty.

In the normal course of business, the Company indemnifies other parties, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other parties harmless 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. In addition, the Company has entered into indemnification agreements with its officers and directors, and the Company's Amended and Restated Bylaws contain similar indemnification obligations to the Company's agents. It is not possible to determine the maximum potential amount under these indemnification agreements due to the Company's limited history with prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on the Company's operating results, financial position, or cash flows.

The Company also provides financing guarantees, which are generally for various third-party financing arrangements to channel partners and other end-user customers. See Note 7 to the Consolidated Financial Statements. The Company's other guarantee arrangements as of January 26, 2013 and July 28, 2012 that were subject to recognition and disclosure requirements were not material.

(f) Legal Proceedings

Brazilian authorities have investigated the Company's Brazilian subsidiary and certain of its current and former employees, as well as a Brazilian importer of the Company's 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 the Company's 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. In the first quarter of fiscal 2013, the Brazilian federal tax authorities asserted an additional claim against the Company's Brazilian subsidiary based on a theory of joint liability with respect to an alleged underpayment of income taxes, social taxes, interest, and penalties by a Brazilian distributor.

The asserted claims by Brazilian federal tax authorities are for calendar years 2003 through 2008, 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 approximately \$426 million for the alleged evasion of import and other taxes, approximately \$1.1 billion for interest, and approximately \$1.9 billion for various penalties, all determined using an exchange rate as of January 26, 2013. The Company has completed a thorough review of the matters and believes the asserted claims against the Company's Brazilian subsidiary are without merit, and the

Company is defending the claims vigorously. While the Company believes 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, the Company is unable to determine the likelihood of an unfavorable outcome against its Brazilian subsidiary and is unable to reasonably estimate a range of loss, if any. The Company does not expect a final judicial determination for several years.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

On March 31, 2011 and April 12, 2011, purported shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against the Company and certain of its officers and directors. The lawsuits have been consolidated, and an amended consolidated complaint was filed on December 2, 2011. The consolidated action is purportedly brought on behalf of purchasers of the Company's publicly traded securities between February 3, 2010 and May 11, 2011. Plaintiffs allege that defendants made false and misleading statements, purport to assert claims for violations of the federal securities laws, and seek unspecified compensatory damages and other relief. The Company believes the claims are without merit and intends to defend the actions vigorously. While the Company believes there is no legal basis for liability, due to the uncertainty surrounding the litigation process, the Company is unable to reasonably estimate a range of loss, if any, at this time.

Beginning on April 8, 2011, a number of purported shareholder derivative lawsuits were filed in both the United States District Court for the Northern District of California and the California Superior Court for the County of Santa Clara against the Company's Board of Directors and several of its officers. The federal lawsuits have been consolidated in the Northern District of California. Plaintiffs in both the federal and state derivative actions allege that the Board allowed certain officers to make allegedly false and misleading statements. The complaint includes claims for violation of the federal securities laws, breach of fiduciary duties, waste of corporate assets, unjust enrichment, and violations of the California Corporations Code. The complaint seeks compensatory damages, disgorgement, and other relief.

The Company is subject to patent claims asserted by VirnetX, Inc. on August 11, 2010 in the Federal District Court for the Eastern District of Texas. VirnetX alleges that various Cisco products that implement a method for secure communication using virtual private networks infringe certain patents. VirnetX seeks monetary damages. The trial on these claims is scheduled to begin in March 2013. The Company believes that it has strong arguments that its products do not use the technology described in the patents and that the patents are invalid. If the jury were to find that Cisco's products infringe and find that the patents are not invalid, the Company believes that damages, as appropriately measured, would not be material given the limited contribution played by the alleged patented technology. However, due to the uncertainty surrounding the litigation process, the Company is unable to reasonably estimate the ultimate outcome of this litigation at this time.

The Company and a service provider customer are subject to patent claims asserted by TiVo, Inc. on June 4, 2012 in the Federal District Court for the Eastern District of Texas. TiVo alleges that the Company's digital video recorders deployed by the service provider customer infringe certain of its patents. TiVo seeks monetary damages and injunctive relief. The trial on these claims is scheduled to begin in March 2014. The Company intends to show at trial that its products do not use the technology described in the patents.

TiVo previously filed a similar patent lawsuit against the same service provider customer, accusing digital video recorders manufactured by one of the Company's competitors. The outcome of that case, which is scheduled for trial in May 2013, could have an impact on the timing and outcome of the Company's case. Due to the uncertainty surrounding the litigation process, which involves numerous defendants, the Company is unable to reasonably estimate the ultimate outcome of this litigation at this time.

In addition, the Company is 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, the Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

13. Shareholders' Equity

(a) Stock Repurchase Program

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of January 26, 2013, the Company's Board of Directors had authorized an aggregate repurchase of up to \$82 billion of common stock under this program, and the remaining authorized repurchase amount was \$5.1 billion with no termination date. A

summary of the stock repurchase activity under the stock repurchase program, reported based on the trade date, is summarized as follows (in millions, except per-share amounts):

	Shares Repurchased	Weighted- Average Price per Share	Amount Repurchased
Cumulative balance at July 28, 2012	3,740	\$20.36	\$76,133
Repurchase of common stock under the stock repurchase program	40	18.73	753
Cumulative balance at January 26, 2013	3,780	\$20.34	\$76,886

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The purchase price for the shares of the Company's stock repurchased is reflected as a reduction to shareholders' equity. The Company is 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. Issuance of common stock and the tax benefit related to employee stock incentive plans are recorded as an increase to common stock and additional paid-in capital.

(b) Cash Dividends on Shares of Common Stock

During the six months ended January 26, 2013, the Company declared and paid cash dividends of \$0.28 per common share, or \$1.5 billion, on the Company's outstanding common stock. During the six months ended January 28, 2012, the Company declared and paid cash dividends of \$0.12 per common share, or \$644 million, on the Company's outstanding common stock.

Any future dividends will be subject to the approval of the Company's Board of Directors.

(c) Other Repurchases of Common Stock

For the six months ended January 26, 2013 and January 28, 2012, the Company repurchased approximately 11 million and 9 million shares, or \$212 million and \$145 million, of common stock, respectively, in settlement of employee tax withholding obligations due upon the vesting of restricted stock or stock units.

(d) Accumulated Other Comprehensive Income

The components of AOCI, net of tax, and the other comprehensive income (loss), excluding noncontrolling interest, for the six months ended January 26, 2013 and January 28, 2012 are summarized as follows (in millions):

	Net Unrealized Gains on Investments	Net Unrealized Gains (Losses) Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Other	Accumulated Other Comprehensive Income
BALANCE AT JULY 28, 2012	\$409	\$ (53)	\$305	\$661
Other comprehensive income attributable to Cisco Systems, Inc.	52	65	120	237
BALANCE AT JANUARY 26, 2013	\$461	\$12	\$425	\$898
	Net Unrealized Gains on Investments	Net Unrealized Gains (Losses) Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Other	Accumulated Other Comprehensive Income
BALANCE AT JULY 30, 2011	\$487	\$6	\$801	\$1,294
Other comprehensive loss attributable to Cisco Systems, Inc.	(59)	(68)	(317)	(444)
BALANCE AT JANUARY 28, 2012	\$428	\$ (62)	\$484	\$850

14. Employee Benefit Plans

(a) Employee Stock Incentive Plans

Stock Incentive Plan Program Description As of January 26, 2013, the Company had five stock incentive plans: the 2005 Stock Incentive Plan (the "2005 Plan"); the 1996 Stock Incentive Plan (the "1996 Plan"); the 1997 Supplemental Stock Incentive Plan (the "Supplemental Plan"); the Cisco Systems, Inc. SA Acquisition Long-Term Incentive Plan (the "SA Acquisition Plan"); and the Cisco Systems, Inc. WebEx Acquisition Long-Term Incentive Plan (the "WebEx Acquisition Plan"). In addition, the Company has, in connection with the 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 the Company and provide incentives for them to remain with the Company. The number and frequency of share-based awards are based on competitive practices, operating results of the Company, government regulations, and other factors. Since the inception of the stock incentive plans, the Company has granted share-based awards to a significant percentage of its employees, and the majority has been granted to employees below the vice president level. The Company's primary stock incentive plans are summarized as follows:

2005 Plan As amended on November 15, 2007, the maximum number of shares issuable under the 2005 Plan over its term is 559 million shares plus the amount of any shares underlying awards outstanding on November 15, 2007 under the 1996 Plan,

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

the SA Acquisition Plan, and the WebEx Acquisition Plan 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, then the shares underlying the awards will again be available under the 2005 Plan.

Pursuant to an amendment approved by the Company's shareholders on November 12, 2009, the number of shares available for issuance under the 2005 Plan was reduced by 1.5 shares for each share awarded as a stock grant or a stock unit, and any shares underlying awards outstanding under the 1996 Plan, the SA Acquisition Plan, and the WebEx Acquisition Plan 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, 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 the Company and its subsidiaries and affiliates, and non-employee directors of the Company. 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 and prior to November 12, 2009 have an expiration date no later than nine years from the grant date. The expiration date for stock options and stock appreciation rights granted subsequent to the amendment approved on November 12, 2009 shall be no later than ten 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 or 36 months, respectively. Time-based stock grants and time-based RSUs will generally vest with respect to 20% or 25% of the shares or share units covered by the grant on each of the first through fifth or fourth anniversaries of the date of the grant, respectively. Performance-based and market-based RSUs typically vest at the end of the three year requisite service period or earlier if the award recipient meets certain retirement eligibility conditions. The Compensation and Management Development Committee of the 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.

1996 Plan The 1996 Plan expired on December 31, 2006, and the Company can no longer make equity awards under the 1996 Plan. The maximum number of shares issuable over the term of the 1996 Plan was 2.5 billion shares. Stock options granted under the 1996 Plan have an exercise price of at least 100% of the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The stock options 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 or 36 months, respectively. Certain other grants have utilized a 60-month ratable vesting schedule. In addition, the Board of Directors, or other committees administering the 1996 Plan, have the discretion to use a different vesting schedule and have done so from time to time.

Supplemental Plan The Supplemental Plan expired on December 31, 2007, and the Company can no longer make equity awards under the Supplemental Plan. Officers and members of the Company's Board of Directors were not eligible to participate in the Supplemental Plan. Nine million shares were reserved for issuance under the Supplemental Plan.

Acquisition Plans In connection with the Company's acquisitions of Scientific-Atlanta, Inc. ("Scientific-Atlanta") and WebEx Communications, Inc. ("WebEx"), the Company adopted the SA Acquisition Plan and the WebEx Acquisition Plan, respectively, each effective upon completion of the applicable acquisition. These plans constitute assumptions, amendments, restatements, and renamings of the 2003 Long-Term Incentive Plan of Scientific-Atlanta and the WebEx Communications, Inc. Amended and Restated 2000 Stock Incentive Plan, respectively. The plans permit the grant of stock options, stock, stock units, and stock appreciation rights to certain employees of the Company and its subsidiaries and affiliates who had been employed by Scientific-Atlanta or its subsidiaries or WebEx or its

subsidiaries, as applicable. As a result of the shareholder approval of the amendment and extension of the 2005 Plan, as of November 15, 2007, the Company will no longer make stock option grants or direct share issuances under either the SA Acquisition Plan or the WebEx Acquisition Plan.

(b)Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its subplan, the International Employee Stock Purchase Plan (together, the "Purchase Plan"), under which 471.4 million shares of the Company's common stock have been reserved for issuance as of January 26, 2013. 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 the Company's 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 January 3, 2020. The Company issued 18 million shares under the Purchase Plan during each of the six months ended January 26, 2013 and January 28, 2012. As of January 26, 2013, 69 million shares were available for issuance under the Purchase Plan.

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 restricted stock units granted to employees. The following table summarizes share-based compensation expense (in millions):

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Cost of sales - product	\$11	\$14	\$21	\$27
Cost of sales - service	36	40	71	77
Share-based compensation expense in cost of sales	47	54	92	104
Research and development	72	99	156	200
Sales and marketing	135	149	265	291
General and administrative	48	54	98	102
Restructuring and other charges	—	(2)	(3)	(2)
Share-based compensation expense in operating expenses	255	300	516	591
Total share-based compensation expense	\$302	\$354	\$608	\$695

As of January 26, 2013, the total compensation cost related to unvested share-based awards not yet recognized was \$2.3 billion, which is expected to be recognized over approximately 2.6 years on a weighted-average basis. The income tax benefit for share-based compensation expense was \$80 million and \$159 million for the three and six months ended January 26, 2013, respectively, and \$93 million and \$183 million for the three and six months ended January 28, 2012, respectively.

The Company uses third-party analyses to assist in developing the assumptions used in, as well as calibrating, its lattice-binomial and Black-Scholes models. The Company is responsible for determining the assumptions used in estimating the fair value of its share-based payment awards.

The Company used the implied volatility for traded options (with contract terms corresponding to the expected life of the employee stock purchase rights) on the Company's stock as the expected volatility assumption required in the Black-Scholes model. The implied volatility is more representative of future stock price trends than historical volatility. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company's employee stock purchase rights. The dividend yield assumption is based on the history and expectation of dividend payouts at the grant date.

The use of the lattice-binomial model requires extensive actual employee exercise behavior data for the relative probability estimation purpose, and a number of complex assumptions as presented in the preceding table. The estimated kurtosis and skewness are technical measures of the distribution of stock price returns, which affect expected employee stock option exercise behaviors, and are based on the Company's stock price return history as well as consideration of various academic analyses. The expected life of employee stock options is a derived output of the lattice-binomial model, which represents the weighted-average period the stock options are expected to remain outstanding.

(d) Share-Based Awards Available for Grant

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

BALANCE AT JULY 30, 2011	Share-Based Awards Available for Grant	255
Restricted stock, stock units, and other share-based awards granted		(95)

Share-based awards canceled/forfeited/expired	64	
Other	(6)
BALANCE AT JULY 28, 2012	218	
Restricted stock, stock units, and other share-based awards granted	(78)
Share-based awards canceled/forfeited/expired	89	
Other	(3)
BALANCE AT JANUARY 26, 2013	226	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As reflected in the preceding table, for each share awarded as restricted stock or subject to a restricted stock unit award under the 2005 Plan, an equivalent of 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.

(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 restricted stock units, is as follows (in millions, except per-share amounts):

	Restricted Stock/Stock Units	Weighted-Average Grant Date Fair Value per Share	Aggregated Fair Market Value
UNVESTED BALANCE AT JULY 30, 2011	116	\$21.50	
Granted and assumed	65	17.45	
Vested	(35)	21.94	\$ 580
Canceled/forfeited	(18)	20.38	
UNVESTED BALANCE AT JULY 28, 2012	128	19.46	
Granted and assumed	55	17.35	
Vested	(33)	21.03	\$ 624
Canceled/forfeited	(5)	18.33	
UNVESTED BALANCE AT JANUARY 26, 2013	145	\$18.35	

The valuation of RSUs is summarized as follows:

	Three Months Ended		Six Months Ended		
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012	
Number of shares granted (in millions)	37	33	48	44	
Weighted- average grant date fair value per share	\$17.07	\$17.88	\$17.20	\$17.34	
Expected dividend yield	3.1	% 1.3	% 3.0	% 1.3	%

In addition to the RSUs in the preceding table, the Company granted approximately 4 million performance-based stock unit awards ("PRSUs") during the first quarter of fiscal 2013. The Company granted approximately 1 million and 2 million such awards for the three and six months ended January 28, 2012, respectively. These PRSUs are contingent on the achievement of the Company's financial performance metrics or its comparative market-based returns. On the date of grant, the Company estimated the fair value of restricted stock units with market-based conditions using a Monte Carlo simulation model. The Company used the assumptions in the preceding table to determine the grant date fair value of restricted stock units with performance metrics conditions.

(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 30, 2011	621	\$ 21.79
Assumed from acquisitions	1	2.08
Exercised	(66)	13.51
Canceled/forfeited/expired	(36)	23.40
BALANCE AT JULY 28, 2012	520	22.68
Assumed from acquisitions	7	0.92

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Exercised	(26)	15.25
Canceled/forfeited/expired	(82)	21.32
BALANCE AT JANUARY 26, 2013	419		\$ 23.08

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

The following table summarizes significant ranges of outstanding and exercisable stock options as of January 26, 2013 (in millions, except years and share prices):

Range of Exercise Prices	STOCK OPTIONS OUTSTANDING				STOCK OPTIONS EXERCISABLE		
	Number Outstanding	Weighted-Average Remaining Contractual Life (in Years)	Weighted-Average Exercise Price per Share	Aggregate Intrinsic Value	Number Exercisable	Weighted-Average Exercise Price per Share	Aggregate Intrinsic Value
\$ 0.01 – 15.00	11	5.80	\$ 4.83	\$181	7	\$ 7.20	\$91
15.01 – 18.00	69	1.66	17.79	232	69	17.79	231
18.01 – 20.00	86	0.86	19.17	170	86	19.17	170
20.01 – 25.00	129	2.48	22.77	7	128	22.77	8
25.01 – 35.00	124	3.62	30.69	—	123	30.71	—
Total	419	2.44	\$ 23.08	\$590	413	\$ 23.31	\$500

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$21.15 as of January 25, 2013, which would have been received by the option holders had those option holders exercised their stock options as of that date. The total number of in-the-money stock options exercisable as of January 26, 2013 was 174 million. As of July 28, 2012, 512 million outstanding stock options were exercisable and the weighted-average exercise price was \$22.65.

15. Income Taxes

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Income before provision for (benefit from) income taxes	\$2,780	\$2,749	\$5,411	\$4,994
Provision for (benefit from) income taxes	\$(363)	\$567	\$176	\$1,035
Effective tax rate	(13.1)%	20.6%	3.3%	20.7%

As discussed further below, the effective tax rate for the three and six months ended January 26, 2013 reflected the Company's recognition of total tax benefits of approximately \$926 million related to a tax settlement with the Internal Revenue Service ("IRS") and the reinstatement of the U.S. federal research and development ("R&D") tax credit on January 2, 2013.

In the second quarter of fiscal 2013, the IRS and the Company settled all outstanding items related to the audit of the Company's federal income tax returns for the fiscal years ended July 27, 2002 through July 28, 2007. As a result of the settlement, the Company increased its income tax receivable by \$733 million and recognized a net benefit to the provision for income taxes of \$794 million, which included a reduction in interest expense of \$157 million. The Company is no longer subject to U.S. federal income tax audit through fiscal 2007.

As a result of the IRS tax settlement, the amount of gross unrecognized tax benefits was reduced by approximately \$1.0 billion, of which \$154 million, which was previously paid by the Company, became certain as a result of completing the audit. The total amount of gross unrecognized tax benefits was \$1.9 billion as of January 26, 2013, of which \$1.6 billion would affect the effective tax rate if realized. Although timing of the resolution of audits is highly uncertain, the Company does not believe it is reasonably possible that the total amount of unrecognized tax benefits as of January 26, 2013 will materially change in the next 12 months.

In the second quarter of fiscal 2013, the American Taxpayer Relief Act of 2012 reinstated the U.S. federal R&D tax credit, retroactive to January 1, 2012. As a result, during the three months ended January 26, 2013, the Company

recognized total tax benefits of \$132 million, of which \$72 million related to fiscal 2012 R&D expenses.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

16. Segment Information and Major Customers

(a) Net Sales and Gross Margin by Segment

The Company conducts business globally and is primarily managed on a geographic basis consisting of three segments: the Americas; EMEA; and APJC. The Company's management makes financial decisions and allocates resources based on the information it receives from its internal management system. Sales are attributed to a segment based on the ordering location of the customer. The Company does not allocate research and development, sales and marketing, or general and administrative expenses to its segments in this internal management system because management does not include the information in its measurement of the performance of the operating segments. In addition, the Company does not allocate amortization and impairment of acquisition-related intangible assets, share-based compensation expense, impacts to cost of sales from purchase accounting adjustments to inventory, 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 its measurement of the performance of the operating segments.

Summarized financial information by segment for the three and six months ended January 26, 2013 and January 28, 2012, based on the Company's internal management system and as utilized by the Company's Chief Operating Decision Maker ("CODM"), is as follows (in millions):

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Net sales:				
Americas	\$7,136	\$6,552	\$14,159	\$13,140
EMEA	3,093	3,250	5,934	6,095
APJC	1,869	1,725	3,881	3,548
Total	\$12,098	\$11,527	\$23,974	\$22,783
Gross margin:				
Americas	4,413	4,106	8,881	8,266
EMEA	2,008	2,095	3,806	3,849
APJC	1,121	992	2,297	2,100
Segment total	7,542	7,193	14,984	14,215
Unallocated corporate items	(199	) (128	) (402	) (260
Total	\$7,343	\$7,065	\$14,582	\$13,955

Net sales in the United States, which is included in the Americas, were \$6.1 billion and \$5.6 billion for the three months ended January 26, 2013 and January 28, 2012, respectively, and were \$12.2 billion and \$11.2 billion for the six months ended January 26, 2013 and January 28, 2012, respectively.

(b) Net Sales for Groups of Similar Products and Services

The Company designs, manufactures, and sells Internet Protocol ("IP")-based networking and other products related to the communications and IT industry and provides services associated with these products and their use. The Company groups its products and technologies into the following categories: Switching, NGN Routing, Service Provider Video, Collaboration, Data Center, Wireless, Security, and Other Products. These products, primarily integrated by Cisco IOS Software, link geographically dispersed local-area networks ("LANs"), metropolitan-area networks ("MANs"), and wide-area networks ("WANs"). The Company has made certain reclassifications to the prior period amounts to conform to the current period's presentation.

CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Net sales:				
Switching	\$3,724	\$3,621	\$7,340	\$7,308
NGN Routing	1,946	2,068	3,998	4,162
Service Provider Video	1,220	1,014	2,368	1,897
Collaboration	945	1,060	1,965	2,168
Data Center	548	333	965	592
Wireless	520	409	1,006	762
Security	336	333	674	652
Other	198	280	418	529
Product	9,437	9,118	18,734	18,070
Service	2,661	2,409	5,240	4,713
Total	\$12,098	\$11,527	\$23,974	\$22,783

(c) Additional Segment Information

The majority of the Company's assets, excluding cash and cash equivalents and investments, as of January 26, 2013 and July 28, 2012 were attributable to its U.S. operations. The Company's total cash and cash equivalents and investments held by various foreign subsidiaries were \$39.4 billion and \$42.5 billion as of January 26, 2013 and July 28, 2012, respectively, and the remaining \$7.0 billion and \$6.2 billion at the respective period ends was available in the United States.

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, 2013	July 28, 2012
Property and equipment, net:		
United States	\$2,808	\$2,842
International	595	560
Total	\$3,403	\$3,402

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

17. Net Income per Share

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

	Three Months Ended		Six Months Ended	
	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012
Net income	\$3,143	\$2,182	\$5,235	\$3,959
Weighted-average shares - basic	5,318	5,368	5,310	5,381
Effect of dilutive potential common shares	39	33	34	23
Weighted-average shares - diluted	5,357	5,401	5,344	5,404
Net income per share - basic	\$0.59	\$0.41	\$0.99	\$0.74
Net income per share - diluted	\$0.59	\$0.40	\$0.98	\$0.73
Antidilutive employee share-based awards, excluded	324	532	519	692

Employee equity share options, unvested shares, and similar equity instruments granted by the Company 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, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are collectively assumed to be used to repurchase shares.

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," "seeks," "estimates," "continues," "envisions," "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 identified below, 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

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. We provide a broad line of products for transporting data, voice, and video within buildings, across campuses, and around the world. Our products are designed to transform how people connect, communicate, and collaborate. Our products are utilized at enterprise businesses, public institutions, telecommunications companies and other service providers, commercial businesses, and personal residences.

A summary of our results is as follows (in millions, except percentages and per-share amounts):

	Three Months Ended			Six Months Ended			Variance	
	January 26, 2013	January 28, 2012		January 26, 2013	January 28, 2012			
Net sales	\$12,098	\$11,527	5.0	%	\$23,974	\$22,783	5.2	%
Gross margin percentage	60.7	% 61.3	% (0.6)	) pts	60.8	% 61.3	% (0.5)	) pts
Research and development	\$1,452	\$1,339	8.4	%	\$2,883	\$2,714	6.2	%
Sales and marketing	\$2,387	\$2,395	(0.3)	)%	\$4,803	\$4,847	(0.9))%
General and administrative	\$584	\$497	17.5	%	\$1,144	\$1,049	9.1	%
Total R&D, sales and marketing, general and administrative	\$4,423	\$4,231	4.5	%	\$8,830	\$8,610	2.6	%
Total as a percentage of revenue	36.6	% 36.7	% (0.1)	) pts	36.8	% 37.8	% (1.0)	) pts
Amortization of purchased intangible assets	\$118	\$97	21.6	%	\$240	\$196	22.4	%
Restructuring and other charges	\$13	\$3	333.3	%	\$72	\$205	(64.9))%
Operating income as a percentage of revenue	23.1	% 23.7	% (0.6)	) pts	22.7	% 21.7	% 1.0	pts
Income tax percentage	(13.1)	)% 20.6	% (33.7)	) pts	3.3	% 20.7	% (17.4)	) pts
Net income	\$3,143	\$2,182	44.0	%	\$5,235	\$3,959	32.2	%
Net income as a percentage of revenue	26.0	% 18.9	% 7.1	pts	21.8	% 17.4	% 4.4	pts
Earnings per share-diluted	\$0.59	\$0.40	47.5	%	\$0.98	\$0.73	34.2	%

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

For the second fiscal quarter of fiscal 2013, diluted earnings per share increased by 48% from the prior year period, a result of both a 44% increase in net income and a decline in our diluted share count by 44 million shares.

Approximately 96% of the increase in net income was due to our recognition of total tax benefits of \$926 million, based primarily on the IRS completing its audit of our federal income tax returns for fiscal 2002 through fiscal 2007 and the reinstatement of the U.S. federal R&D tax credit.

We continued to execute on our plan to deliver profitable growth over the long term by maintaining our focus on operational excellence and portfolio management. Net sales increased 5% with net product sales increasing 3% and service revenue increasing 10%. The net product sales increase was in large part due to our acquisition of NDS, which was completed at the beginning of fiscal 2013. Operating income as a percentage of revenue decreased by 0.6 percentage points, primarily as a result of a lower gross margin percentage. Contributing to the lower gross margin percentage was higher amortization of purchased intangible assets resulting from recent acquisitions.

For the second quarter of fiscal 2013, as compared with the prior year period, revenue increased by \$0.6 billion. The Americas contributed \$0.6 billion of the increase led by a sales increase of 9% in the United States. APJC contributed \$0.1 billion to the revenue increase led by strong sales growth in India. We continued to experience weakness in the European economy, and we expect that this could continue in the future. Revenue in our EMEA segment declined by \$0.2 billion, with revenue declines in France, Germany, and the United Kingdom being only partially offset by solid revenue growth in Russia and certain other countries in the segment.

For the second quarter of fiscal 2013, as compared with the prior year period, net product sales and service revenue each increased by \$0.3 billion. The product sales increase was driven by the following: an increase of \$0.2 billion from Service Provider Video driven by the acquisition of NDS at the beginning of fiscal 2013; an increase of \$0.2 billion from Data Center products, due to continued strong customer demand; an increase of \$0.1 billion from Wireless products, due to continued demand for these solutions, and an increase of \$0.1 billion from our Switching Products. These sales increases, along with the service revenue contribution, reflect, in our view, the success we are experiencing with our technology architectures and our ability to deliver customer solutions, particularly in the enterprise and service provider data center and cloud environments.

The continuing weakness we experienced in the second quarter in the EMEA segment and with regard to global public sector spending, especially in the United States, contributed to a net product sales decrease of \$0.1 billion in our Collaboration product category. We also experienced a decrease of \$0.1 billion in our NGN Routing product category, driven by sales declines in APJC, in particular China, and EMEA. In addition, sales in our Other product category decreased by \$0.1 billion due in large part to lower sales of Linksys home networking products and lower sales of other networking products.

In summary, during the second quarter of fiscal 2013, we continued to execute on our plan to deliver profitable growth over the long term. We did so as we continued to experience the global macroeconomic challenges we faced in recent quarters including, in particular, weakness in the European economy, lower global public sector spending, and a conservative approach to IT-related capital spending by our other customers.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

Diluted earnings per share increased by 34% from the prior year, a result of both a 32% increase in net income and a decline by our diluted share count of 60 million shares. A significant portion of the favorable increase in net income was attributable to the tax benefits recognized in the second quarter of fiscal 2013 discussed above. Net sales increased 5%, with net product sales increasing 4% and service revenue increasing 11%. The increase in net product sales was due in large part to our acquisition of NDS. We achieved net sales increases in our Americas and APJC geographic segments while net sales in our EMEA geographic segment declined. Total gross margin decreased by 0.5 percentage points. As a percentage of revenue, research and development, sales and marketing, and general and administrative expenses collectively declined by 1.0 percentage point primarily due to lower sales and marketing expenses. Operating income as a percentage of revenue increased by 1.0 percentage point, primarily as a result of lower restructuring charges and effective expense management.

Strategy and Focus Areas

Our focus continues to be on our five foundational priorities:

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Leadership in our core business (routing, switching, and associated services), which includes comprehensive security and mobility solutions

• Collaboration

• Data center virtualization and cloud

• Video

• Architectures for business transformation

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We believe that focusing on these priorities best positions us to continue to expand our share of our customers' information technology spending.

We continue to undergo product transitions in our core business, including the introduction of next-generation products with higher price performance and architectural advantages compared with both our prior generation of products and the product offerings of our competitors. We believe that many of these product transitions are gaining momentum based on the strong year-over-year product revenue growth across these next-generation product families. We believe that our strategy and our ability to innovate and execute may enable us to improve our relative competitive position in many of our product areas even in uncertain or difficult business conditions and, therefore, may continue to provide us with long-term growth opportunities. However, we believe that these newly introduced products may continue to negatively impact product gross margins, which we are currently striving to address through various initiatives, including value engineering; effective supply chain management; and delivering greater customer value through offers that include hardware, software, and services.

We continue to seek to capitalize on market transitions. Market transitions relating to the network are becoming, in our view, more significant as intelligent networks have moved from being a mere cost center issue—that is, where the focus is on reducing network operating costs and increasing network-related productivity—to becoming, additionally and increasingly, a platform for improved revenue generation as well as driving business agility and strategy execution.

Market transitions for which we are primarily focused include those related to the increased role of virtualization/the cloud, video, collaboration, networked mobility technologies, the transition from Internet Protocol Version 4 to Internet Protocol Version 6, and the Internet of Everything. For example, a market in which a significant market transition is underway is the enterprise data center market, where a transition to virtualization / the cloud is rapidly evolving. There is a continued growing awareness that intelligent networks are becoming the platform for productivity improvement and global competitiveness. We believe that disruption in the enterprise data center market is accelerating, due to changing technology trends such as the increasing adoption of virtualization, the rise in scalable processing, and the advent of cloud computing and cloud-based IT resource deployments and business models. These key terms are defined as follows:

Virtualization: Refers to the process of creating a virtual, or nonphysical, version of a device or resource, such as a server, storage device, network or an operating system, in such a way that human users as well as other devices and resources are able to interact with the virtual resource as if it were an actual physical resource. For example, one type of virtualization is server or data center virtualization, which consists of aggregating the current siloed data center resources into unified, shared resource pools that can be dynamically delivered to applications on demand, thus enabling the ability to move content and applications between devices and the network.

The cloud: Refers to an information technology hosting and delivery system in which resources, such as servers or software applications, are no longer tethered to a user's physical infrastructure but instead are delivered to and consumed by the user “on demand” as an Internet-based service, whether singularly or with multiple other users simultaneously.

This virtualization and cloud-driven market transition in the enterprise data center market is being brought about through the convergence of networking, computing, storage, and software technologies. We are seeking to take advantage of this market transition through, among other things, our Cisco Unified Computing System platform and Cisco Nexus product families, which are designed to integrate the previously siloed technologies in the enterprise data center with a unified architecture. We are also seeking to capitalize on this market transition through the development of other cloud-based product and service offerings through which we intend to enable customers to develop and deploy their own cloud-based IT solutions, including software-as-a-service (“SaaS”) and other-as-a-service (“XaaS”) solutions.

The competitive landscape in the enterprise data center market is changing. Very large, well-financed, and aggressive competitors are each bringing their own new class of products to address this new market. We expect this competitive market trend to continue. With respect to this market, we believe the network will be the intersection of innovation through an open ecosystem and standards. We expect to see acquisitions, further industry consolidation, and new alliances among companies as they seek to serve the enterprise data center market. As we enter this next market phase, we expect that we will strengthen certain strategic alliances, compete more with certain strategic alliances and

partners, and perhaps also encounter new competitors in our attempt to deliver the best solutions for our customers. We believe that the architectural approach that we have undertaken in the enterprise data center market is adaptable to other markets. An example of a market where we aim to apply this approach is mobility, where growth of IP traffic on handheld devices is driving the need for more robust architectures, equipment and services in order to accommodate not only an increasing number of worldwide mobile device users, but also increased user demand for broadband-quality business network and consumer web applications to be delivered on such devices. A key term in this mobility-centered market transition is “BYOD,” an acronym for “bring your own device,” which in the context of IT usage in companies, universities, and other organizations refers to the growing trend of employees, customers, students, and others associated with such entities to bring

and use their own laptop computers, smartphones, tablets or other mobile devices for their work or participation, instead of using equipment provided by the organization.

With regard to this market transition, to help such organizations meet the demands of increasing BYOD usage, our product development strategy involves a comprehensive architectural approach that will allow for, among other things, a unified security policy across the whole organization; a simplified operations and network management structure that understands application performance from a user's perspective, enhances troubleshooting capability and lowers network operating costs; and an uncompromised user experience over the organization's entire wireless and wired network that embraces use of any kind of device. Our mobility-related products and solutions reflect this architectural-based approach.

Other market transitions on which we are focusing particular attention include those related to the convergence of video, collaboration, and networked mobility technologies, which we believe will drive productivity and growth in network loads and which convergence appears to be evolving even more quickly and more significantly than we had previously anticipated. Cisco TelePresence systems are one example of product offerings that have incorporated video, collaboration, and networked mobility technologies, as customers evolve their communications and business models. More generally, we are focused on simplifying and expanding the creation, distribution, and use of end-to-end video solutions for businesses and consumers.

Another market transition on which we are focusing is the move toward more programmable, flexible, and virtual networks. This move to network programmability encompasses technologies such as software-defined networking and is focused on moving from a hardware-centric approach for networking to a virtualized network environment that is designed to enable flexible, application-driven customization of network infrastructures. We believe the successful products and solutions in this market will combine application-specific-integrated-circuits ("ASICs") with hardware and software elements together to meet customers' total cost of ownership, quality, security, scalability and experience requirements. In our view, there is no single architecture that supports all customer requirements in this area. Our strategy is targeted to address a broad range of specific customer use cases.

Recently, we announced an additional set of network programmability capabilities with the announcement of the Cisco Open Network Environment, or Cisco ONE, including overlay network technology, application programming interfaces ("APIs"), and network-operation tools called agents and controllers. In our view, this evolution is in its very early stages and presents an opportunity for Cisco. We intend to continue to drive internal innovation, partner for co-development, and make strategic investments to lead this evolution.

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 2013 (in millions, except days sales outstanding in accounts receivable ("DSO") and annualized inventory turns):

	January 26, 2013	July 28, 2012
Cash and cash equivalents and investments	\$46,376	\$48,716
Deferred revenue	\$13,321	\$12,880
DSO	34 days	34 days
Inventories	\$1,574	\$1,663
Annualized inventory turns	11.6	11.7
	Six Months Ended	
	January 26, 2013	January 28, 2012
Cash provided by operating activities	\$5,814	\$5,434
Repurchases of common stock - stock repurchase program	\$753	\$2,010
Dividends	\$1,487	\$644

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, 2012, 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

Revenue is recognized when all of the following criteria have been met:

- Persuasive evidence of an arrangement exists. Contracts, Internet commerce agreements, and customer purchase orders are generally used to determine the existence of an arrangement.
- Delivery has occurred. Shipping documents and customer acceptance, when applicable, are used to verify delivery.
- The fee is fixed or determinable. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment.
- Collectibility is reasonably assured. We assess collectibility based primarily on the creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

In instances where final acceptance of the product, system, or solution is specified by the customer, revenue is deferred until all acceptance criteria have been met. When a sale involves multiple deliverables, such as sales of products that include services, the multiple deliverables are evaluated to determine the unit of accounting, and the entire fee from the arrangement is allocated to each unit of accounting based on the relative selling price. Revenue is recognized when the revenue recognition criteria for each unit of accounting are met.

The amount of product and service revenue recognized in a given period is affected by our judgment as to whether an arrangement includes multiple deliverables and, if so, our valuation of the units of accounting for multiple deliverables. According to the accounting guidance prescribed in Accounting Standards Codification ("ASC") 605, Revenue Recognition, we use vendor-specific objective evidence of selling price ("VSOE") for each of those units, when available. We determine VSOE based on our normal pricing and discounting practices for the specific product or service when sold separately. In determining VSOE, we require that a substantial majority of the historical standalone transactions have the selling prices for a product or service fall within a reasonably narrow pricing range, generally evidenced by approximately 80% of such historical standalone transactions falling within plus or minus 15% of the median rates. When VSOE does not exist, we apply the selling price hierarchy to applicable multiple-deliverable arrangements. Under the selling price hierarchy, third-party evidence of selling price ("TPE") will be considered if VSOE does not exist, and estimated selling price ("ESP") will be used if neither VSOE nor TPE is available. Generally, we are not able to determine TPE because our go-to-market strategy differs from that of others in our markets, and the extent of our proprietary technology varies among comparable products or services from those of our peers. In determining ESP, we apply significant judgment as we weigh a variety of factors, based on the facts and circumstances of the arrangement. We typically arrive at an ESP for a product or service that is not sold separately by considering company-specific factors such as geographies, competitive landscape, internal costs, profitability objectives, pricing practices used to establish bundled pricing, and existing portfolio pricing and discounting. Some of our sales arrangements have multiple deliverables containing software and related software support components. Such sales arrangements are subject to the accounting guidance in ASC 985-605, Software-Revenue Recognition.

As our business and offerings evolve over time, our pricing practices may be required to be modified accordingly, which could result in changes in selling prices, including both VSOE and ESP, in subsequent periods. There were no material impacts during the quarter nor do we currently expect a material impact in the next twelve months on our revenue recognition due to any changes in our VSOE, TPE, or ESP.

Revenue deferrals relate to the timing of revenue recognition for specific transactions based on financing arrangements, service, support, and other factors. Financing arrangements may include sales-type, direct-financing,

and operating leases, loans, and guarantees of third-party financing. Our deferred revenue for products was \$4.3 billion and \$3.7 billion as of January 26, 2013 and July 28, 2012, respectively. Technical support services revenue is deferred and recognized ratably over the period during which the services are to be performed, which typically is from one to three years. Advanced services revenue is recognized upon delivery or completion of performance. Our deferred revenue for services was \$9.1 billion and \$9.2 billion as of January 26, 2013 and July 28, 2012, respectively.

We make sales to distributors and retail partners, which we refer to as two-tier systems of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. Our distributors and retail partners participate in various cooperative marketing and other programs, and we maintain estimated accruals and allowances for these programs. If actual credits received by our distributors and retail partners under these programs were to deviate significantly from our estimates, which are based on historical experience, our revenue could be adversely affected.

Allowances for Receivables and Sales Returns

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

	January 26, 2013		July 28, 2012	
Allowance for doubtful accounts	\$218		\$207	
Percentage of gross accounts receivable	4.7	%	4.5	%
Allowance for credit loss - lease receivables	\$247		\$247	
Percentage of gross lease receivables	6.6	%	7.2	%
Allowance for credit loss - loan receivables	\$101		\$122	
Percentage of gross loan receivables	5.7	%	6.8	%

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 and expected default frequency rates, which are published by major third-party credit-rating agencies and are generally 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 revenue.

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 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. Determination of expected default frequency rates and loss factors associated with internal credit risk ratings as well as assessing 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 revenue. 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 both January 26, 2013 and July 28, 2012 was \$129 million and was recorded as a reduction of our accounts receivable. 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

Our inventory balance was \$1.6 billion and \$1.7 billion as of January 26, 2013 and July 28, 2012, respectively. 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. As of January 26, 2013, the liability for these purchase commitments was \$169 million, compared with \$193 million as of July 28, 2012, and was included in other current liabilities. Our provision for inventory was \$63 million and \$53 million for the first six months of fiscal 2013 and 2012, respectively. The provision for the liability related to purchase commitments with contract manufacturers and suppliers was \$40 million and \$51 million for the first six months of fiscal 2013 and 2012, respectively.

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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. 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, particularly in light of current macroeconomic uncertainties and conditions and the resulting potential for changes in future demand forecast.

Warranty Costs

The liability for product warranties, included in other current liabilities, was \$424 million as of January 26, 2013, compared with \$415 million as of July 28, 2012. See Note 12 to the Consolidated Financial Statements. 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.

The provision for product warranties issued during the first six months of fiscal 2013 and 2012 was \$319 million and \$331 million, respectively. The decrease in the provision for warranties occurred principally due to a warranty charge incurred on a specific product during the second quarter of fiscal 2012. 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.

Share-Based Compensation Expense

Share-based compensation expense is presented as follows (in millions):

	Six Months Ended		Variance
	January 26, 2013	January 28, 2012	
Share-based compensation expense	\$608	\$695	\$(87)

Restricted stock units are valued using the market value of our common stock on the date of grant, discounted for the present value of expected dividends. Restricted stock unit awards with market-based conditions are valued using a Monte Carlo simulation. See Note 14 to the Consolidated Financial Statements.

The determination of the fair value of employee stock options and employee stock purchase rights on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. For employee stock options and employee stock purchase rights, these variables include, but are not limited to, the expected stock price volatility over the term of the awards, the risk-free interest rate, and expected dividends as of the grant date. For employee stock options, we historically have used the implied volatility for two-year traded options on our stock as the expected volatility assumption required in the lattice-binomial model. For employee stock purchase rights, we used the implied volatility for traded options (with lives corresponding to the expected life of the employee stock purchase rights) on our stock. The selection of the implied volatility approach was based upon the availability of actively traded options on our stock and our assessment that implied volatility is more representative of future stock price trends than historical volatility. The valuation of employee stock options is also impacted by kurtosis and skewness, which are technical measures of the distribution of stock price returns and the actual and projected employee stock option exercise behaviors.

Because share-based compensation expense is based on awards ultimately expected to vest, it has been reduced for forfeitures. If factors change and we employ different assumptions in the application of our option-pricing model in future periods or if we experience different forfeiture rates, the compensation expense that is derived may differ significantly from what we have recorded in the current period.

Fair Value Measurements

Our fixed income and publicly traded equity securities, collectively, are reflected in the Consolidated Balance Sheets at a fair value of \$39.5 billion as of January 26, 2013, compared with \$38.9 billion as of July 28, 2012. Our fixed income investment portfolio, as of January 26, 2013, consisted primarily of high-quality investment-grade securities. See Note 8 to the Consolidated Financial Statements.

As described more fully in Note 9 to the Consolidated Financial Statements, a valuation hierarchy is based on the level of independent, objective evidence available regarding the value of the investments. It encompasses three classes of investments: Level 1 consists of securities for which there are quoted prices in active markets for identical securities; Level 2 consists of securities for which observable inputs other than Level 1 inputs are used, such as quoted prices for similar securities in active markets or quoted prices for identical securities in less active markets and model-derived valuations for which the variables are derived from, or corroborated by, observable market data; and Level 3 consists of securities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value.

Our Level 2 securities are valued 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 independent pricing vendors, quoted market prices, or other sources to determine the ultimate fair value of our assets and liabilities. We use such pricing data as the primary input, to which we have not made any material adjustments during fiscal 2013 and fiscal 2012, to make our assessments and determinations as to the ultimate valuation of our investment portfolio. We are ultimately responsible for the financial statements and underlying estimates.

The inputs and fair value are reviewed for reasonableness, may be further validated by comparison to publicly available information, and could be adjusted based on market indices or other information that management deems material to its estimate of fair value. The assessment of fair value can be difficult and subjective. However, given the relative reliability of the inputs we use to value our investment portfolio, and because substantially all of our valuation inputs are obtained using quoted market prices for similar or identical assets, we do not believe that the nature of estimates and assumptions affected by levels of subjectivity and judgment was material to the valuation of the investment portfolio as of January 26, 2013. We had no Level 3 investments in our total portfolio as of January 26, 2013.

Other-than-Temporary Impairments

We recognize an impairment charge when the declines in the fair values of our fixed income or publicly traded equity securities 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.

For publicly traded equity securities, we consider various factors in determining whether we should recognize an impairment charge, including the length of time and extent to which the fair value has been less than our cost basis, the financial condition and near-term prospects of the issuer, and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

There were no impairment charges on our investments in publicly traded equity securities and fixed income securities in the first six months of fiscal 2013 and fiscal 2012. 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.

We also have investments in privately held companies, some of which are in the startup or development stages. As of January 26, 2013, our investments in privately held companies were \$869 million, compared with \$858 million as of July 28, 2012, and were included in other assets. See Note 6 to the Consolidated Financial Statements. We monitor these investments for events or circumstances indicative of potential impairment, and we will 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. Our impairment charges on investments in privately held companies were \$18 million and \$2 million for the first six months of fiscal 2013 and 2012, respectively.

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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.

The goodwill recorded in the Consolidated Balance Sheets as of January 26, 2013 and July 28, 2012 was \$21.4 billion and \$17.0 billion, respectively. The increase in goodwill for the first six months of fiscal 2013 was due in large part to our acquisitions of NDS and Meraki Inc. ("Meraki"). 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 the first six months of fiscal 2013 and 2012.

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 the carrying value may not be recoverable. Recoverability of indefinite-lived intangible assets is measured by comparing the carrying amount of the asset to the future discounted cash flows the asset is expected to generate. 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 2013 and 2012. 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, research and development ("R&D") tax credits, tax audit settlements, nondeductible compensation, international realignments, and transfer pricing adjustments. Our effective tax rate was (13.1%) and 20.6% in the second quarter of fiscal 2013 and 2012, respectively. Our effective tax rate was 3.3% and 20.7% for the first six months of fiscal 2013 and 2012, respectively. 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.

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 expiration of or lapses in the R&D tax credit laws; by expiration of or lapses in tax incentives; by transfer pricing adjustments, including the effect of acquisitions on our intercompany R&D cost-sharing arrangement and 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, including possible U.S. changes to the taxation of earnings of our foreign subsidiaries, the deductibility of expenses attributable to foreign income, or 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 accounting guidance for uncertainty in income taxes applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes or additional paid-in capital.

Further, 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 and in some cases is wholly exempt from tax. 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 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.

Loss Contingencies

We are subject to the possibility of various losses arising in the ordinary course of business. We consider the likelihood of loss or 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 current information available to us to determine whether such accruals should be 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.

RESULTS OF OPERATIONS

Net Sales

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

	Three Months Ended				Six Months Ended					
	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent		
Net sales:										
Product	\$9,437	\$9,118	\$319	3.5 %	\$18,734	\$18,070	\$664	3.7 %		
Percentage of net sales	78.0 %	79.1 %			78.1 %	79.3 %				
Service	2,661	2,409	252	10.5 %	5,240	4,713	527	11.2 %		
Percentage of net sales	22.0 %	20.9 %			21.9 %	20.7 %				
Total	\$12,098	\$11,527	\$571	5.0 %	\$23,974	\$22,783	\$1,191	5.2 %		

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

	Three Months Ended				Six Months Ended					
	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent		
Net sales:										
Americas	\$7,136	\$6,552	\$584	8.9 %	\$14,159	\$13,140	\$1,019	7.8 %		
Percentage of net sales	59.0 %	56.8 %			59.0 %	57.7 %				
EMEA	3,093	3,250	(157)	(4.8)%	5,934	6,095	(161)	(2.6)%		
Percentage of net sales	25.6 %	28.2 %			24.8 %	26.7 %				
APJC	1,869	1,725	144	8.3 %	3,881	3,548	333	9.4 %		
Percentage of net sales	15.4 %	15.0 %			16.2 %	15.6 %				
Total	\$12,098	\$11,527	\$571	5.0 %	\$23,974	\$22,783	\$1,191	5.2 %		

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

For the second quarter of fiscal 2013, as compared with the second quarter of fiscal 2012, net sales increased by 5%.

Net product sales increased by 3%, while service revenue increased by 10%. The increase in net product sales reflected growth in our Americas and APJC geographic segments, while net product sales declined in the EMEA segment. Service revenues increased across all of our geographic segments.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

For the first six months of fiscal 2013, as compared with the first six months of fiscal 2012, net sales increased by 5%.

Net product sales increased by 4%, while service revenue increased by 11%. The increase in net product sales reflected growth in our Americas and APJC geographic segments, while net product sales declined in the EMEA segment. Service revenues increased across all of our geographic segments.

We conduct business globally in numerous currencies. The direct effect of foreign currency fluctuations on sales has not been material because our sales are primarily denominated in U.S. dollars. However, if the U.S. dollar strengthens relative to other currencies, such strengthening could have an indirect effect on our sales to the extent it raises the cost of our products to non-U.S. customers and thereby reduces demand. A weaker U.S. dollar could have the opposite effect. However, the precise indirect effect of currency fluctuations is difficult to measure or predict because our sales

are influenced by many factors in addition to the impact of such currency fluctuations.

In addition to the impact of macroeconomic factors, including a cautious IT spending environment and budget-driven reductions in spending by government entities, net sales 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-element arrangements; the mix of financing arrangements provided to our 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 net sales related to these transactions may also be affected by the timing of revenue recognition, which in turn would impact the net sales of the relevant segment. As has been the case in certain of our emerging countries from time to time, customers require greater levels of financing arrangements, service, and support, and this may occur in future periods, which may also impact the timing of the recognition of revenue.

Net Product Sales by Segment

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

	Three Months Ended			Six Months Ended					
	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	
Net product sales:									
Americas	\$5,389	\$4,973	\$416	8.4 %	\$10,703	\$10,030	\$673	6.7 %	
Percentage of net product sales	57.1 %	54.6 %			57.2 %	55.5 %			
EMEA	2,547	2,748	(201)	(7.3)%	4,879	5,119	(240)	(4.7)%	
Percentage of net product sales	27.0 %	30.1 %			26.0 %	28.3 %			
APJC	1,501	1,397	104	7.4 %	3,152	2,921	231	7.9 %	
Percentage of net product sales	15.9 %	15.3 %			16.8 %	16.2 %			
Total	\$9,437	\$9,118	\$319	3.5 %	\$18,734	\$18,070	\$664	3.7 %	

Americas

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

The increase in net product sales in the Americas segment was led by growth in the commercial, enterprise and service provider markets. The growth in net product sales to the service provider market was in large part due to our acquisition of NDS at the beginning of fiscal 2013. We continued to experience a decline in net product sales in the public sector market for the second quarter of fiscal 2013, which was driven primarily by lower net product sales to the U.S. federal government only partially offset by higher net product sales to state and local governments. From a country perspective, net product sales increased by 9% in the United States, 27% in Mexico, and 5% in Brazil. Net product sales in Canada were flat compared with the corresponding period of fiscal 2012.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The increase in net product sales in the Americas segment was led by growth in the service provider, commercial and enterprise markets. The growth in net product sales to the service provider market was due in part to our acquisition of NDS at the beginning of fiscal 2013. We experienced a decline in net product sales to the public sector market for the first six months of fiscal 2013 as lower net product sales to the U.S. federal government were only partially offset by higher net product sales to state and local governments. From a country perspective, net product sales increased by 9% in the United States, 8% in Mexico and 5% in Brazil. These increases were partially offset by a net product sales decline of 9% in Canada.

EMEA

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Net product sales in the EMEA segment decreased by 7% as weakness from macroeconomic challenges in Europe continued to impact our business in this segment. The decline was led by the enterprise market, followed by lesser declines in the public sector and commercial markets. Net product sales to our service provider market were flat and include net product sales from our acquisition of NDS. From a country perspective, net product sales decreased by 7%

in the Netherlands, 9% in the United Kingdom, 8% in both Germany and France, and 29% in Italy. Partially offsetting these declines was an 8% increase in net product sales to Russia.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The decrease in net product sales occurred across all our customer markets in the EMEA segment, led by declines in the enterprise and public sector markets, followed by smaller declines in the service provider and commercial markets. From a country perspective, net product sales decreased by 20% in the Netherlands, 7% in the United Kingdom, 8% in both Germany and France, and 26% in Italy. Partially offsetting these product sales declines was a 17% increase in net product sales in Russia.

APJC

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

The increase in the APJC segment was led by solid net product sales growth in the commercial market and, to a lesser degree, in the service provider and public sector markets. The growth in the service provider market was due to our acquisition of NDS. Net product sales were flat in the enterprise market in the APJC segment. From a country perspective, net product sales increased by 46% in India, 11% in China, and 4% in Australia, partially offset by a net product sales decline of 14% in Japan.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The increase in the APJC segment was led by strong net product sales growth in the public sector, service provider and commercial markets and, to a lesser degree, in the enterprise market. The growth in the service provider market was in large part due to our acquisition of NDS. From a country perspective, net product sales increased by 41% in India, 1% in China, and 18% in Australia, partially offset by a net product sales decline of 2% in Japan.

Net Product Sales 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. Our product categories consist of the following categories (with subcategories in parentheses): Switching (fixed switching, modular switching, and storage); NGN Routing (high-end routers, mid-range and low-end routers, and other NGN Routing products); Service Provider Video (customer premises equipment and video software and systems (which includes sales of NDS products)); Collaboration (unified communications and Cisco TelePresence); Data Center; Wireless; Security; and Other Products. The Other Products category consists primarily of Linksys home networking products, emerging technology products, and other networking products.

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

	Three Months Ended				Six Months Ended					
	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent		
Net product sales:										
Switching	\$3,724	\$3,621	\$103	2.8 %	\$7,340	\$7,308	\$32	0.4 %		
Percentage of net product sales	39.5 %	39.7 %			39.2 %	40.5 %				
NGN Routing	1,946	2,068	(122)	(5.9)%	3,998	4,162	(164)	(3.9)%		
Percentage of net product sales	20.6 %	22.7 %			21.3 %	23.0 %				
Service Provider Video	1,220	1,014	206	20.3 %	2,368	1,897	471	24.8 %		
Percentage of net product sales	12.9 %	11.1 %			12.6 %	10.5 %				
Collaboration	945	1,060	(115)	(10.8)%	1,965	2,168	(203)	(9.4)%		
Percentage of net product sales	10.0 %	11.5 %			10.5 %	12.0 %				
Data Center	548	333	215	64.6 %	965	592	373	63.0 %		
Percentage of net product sales	5.8 %	3.7 %			5.2 %	3.3 %				
Wireless	520	409	111	27.1 %	1,006	762	244	32.0 %		
Percentage of net product sales	5.5 %	4.5 %			5.4 %	4.2 %				
Security	336	333	3	0.9 %	674	652	22	3.4 %		
Percentage of net product sales	3.6 %	3.7 %			3.6 %	3.6 %				
Other	198	280	(82)	(29.3)%	418	529	(111)	(21.0)%		
Percentage of net product sales	2.1 %	3.1 %			2.2 %	2.9 %				
Total	\$9,437	\$9,118	\$319	3.5 %	\$18,734	\$18,070	\$664	3.7 %		

Certain reclassifications have been made to the prior period amounts to conform to the current period's presentation.

Switching

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Our Switching product category consists of switching and storage products. Sales of LAN fixed-configuration switches increased by 6%, or \$124 million. The increase in sales of LAN fixed-configuration switches was primarily due to higher sales of Cisco Nexus 5000 Series Switches, Cisco Catalyst 3000, 3750 and 4000 Series Switches, and fixed switching optics modules. Sales of modular switches increased \$11 million, or 1%, with higher sales of Cisco Nexus 7000 Series Switches, optics modules, and Cisco Catalyst 4500 Series Switches being partially offset by lower sales of Cisco Catalyst 6500 Series Switches. Net product sales in our Switching product category were negatively impacted by a 22% decrease in sales of storage products.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

Sales of LAN fixed-configuration switches increased by 2%, or \$82 million. The increase in sales of LAN fixed-configuration switches was primarily due to higher sales of Cisco Nexus 5000 Series Switches and fixed switching optics modules, partially offset by sales declines in several of our Cisco Catalyst product families. Sales of modular switches increased \$16 million, or 1%, with higher sales of Cisco Nexus 7000 Series Switches, optics modules, and Cisco Catalyst 4500 Series Switches, being partially offset by lower sales of Cisco Catalyst 6500 Series Switches. Net product sales in our Switching product category were negatively impacted by a 22% decrease in sales of storage products.

NGN Routing

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

We experienced a decrease of \$122 million in our NGN Routing product category, driven by sales declines in APJC, in particular China, and EMEA. From a subcategory perspective, the decrease in sales of our NGN Routing product category was driven by a 6%, or \$67 million, decrease in sales of high-end router products and a 9%, or \$62 million, collective decrease in sales of our mid-range and low-end router products. Within the high-end router products category, we experienced lower sales of our Cisco CRS-3 Carrier Routing System products, and of our legacy high-end router products. These decreases were partially offset by sales growth in Cisco ASR 9000 and 5000 products as we continue to experience product transitions in our high-end product category. We experienced a slight increase in sales of other NGN Routing products due to increased sales of optical networking products, partially offset by lower sales of other routing products.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The decrease in sales of our NGN Routing product category was driven by a 4%, or \$89 million, decrease in sales of high-end router products; a 13%, or \$50 million, decrease in sales of other NGN Routing products; and a 2%, or \$25 million, decrease in sales of our mid-range and low-end router products. Within the high-end router products category, we experienced lower sales of our Cisco CRS-3 Carrier Routing System products, and of our legacy high-end router products. These decreases were partially offset by sales growth in Cisco ASR 9000 and 5000 products. The decline in sales of other NGN Routing products was due to decreased sales of other routing and optical networking products.

Service Provider Video

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Our Service Provider Video product category consists of the following two major subcategories of products: customer premises equipment and video software and systems. The increase in sales of Service Provider Video products was due to the acquisition of NDS at the beginning of fiscal 2013. Within the two subcategories, sales within the video software and systems subcategory, which includes the NDS products, increased by 55%, or \$184 million, while sales of customer premises equipment products increased by 3%, or \$22 million. The increase in sales of customer premises equipment products was due primarily to increased sales of cable set-top boxes.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The increase in sales of Service Provider Video products was in large part due to the acquisition of NDS at the beginning of fiscal 2013, which contributed a substantial majority of the total sales increase. Within the two subcategories, sales within the video software and systems subcategory, which includes the NDS products, increased by 56%, or \$351 million, while sales of customer premises equipment products increased by 10%, or \$120 million. The increase in sales of customer premises equipment products was due primarily to increased sales of cable set-top boxes.

Collaboration

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Our Collaboration product category consists of unified communications products (IP phones, call center and messaging solutions, infrastructure products, and web-based collaborative offerings) and Cisco TelePresence Systems. Sales of Collaboration products decreased primarily due to a decline in sales of Cisco TelePresence Systems. Lower public sector spending in the United States and demand weakness in Europe were the largest drivers of the decrease in sales of Cisco TelePresence Systems. We also experienced a slight decline in unified communications product sales. The decline in unified communications sales was due primarily to lower sales of infrastructure products, partially offset by higher sales of collaborative web-based offerings.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

The sales decrease in our Collaboration product category was primarily due to a decline in sales of Cisco TelePresence Systems along with a slight decline in sales of unified communications products. The decline in sales of Cisco TelePresence Systems was due to similar factors as those affecting the three month period discussed in the paragraph immediately above. The slight decline in unified communications sales was due primarily to lower sales of unified communications infrastructure products and lower sales of collaborative web-based offerings.

Data Center

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Sales of Data Center products increased significantly due to increased sales of Cisco Unified Computing System products. The increase was due in large part to the momentum we are experiencing with our products for the commercial, enterprise, and service provider data center and cloud environments, as current customers increase their data center build-outs, and as new customers purchase products.

To the extent our Data Center business grows and further penetrates the market, we expect that, in comparison to what we have experienced during the initial rapid growth of this business, the growth rates for our Data Center product sales will experience more normal seasonality consistent with the overall server market.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

Sales of Data Center products increased significantly due to increased sales of Cisco Unified Computing System products. The increase was due in large part to similar factors as those affecting the three month period discussed immediately above.

Wireless, Security, and Other

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Sales of Wireless products increased 27%, or \$111 million, primarily reflecting the continued customer adoption of and migration to the Cisco Unified Wireless Network architecture, and also reflecting increased sales of new products in this category. Sales of our Security products were up slightly, as sales of our content security and network security subcategories each increased slightly. We experienced a decrease in sales of Other Products due in large part to lower sales of Linksys home networking products and lower sales of other networking products. In the second quarter of fiscal 2013, we agreed to sell our Linksys product line to a third party, which transaction is expected to close during the third quarter of fiscal 2013.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

Sales of Wireless products increased 32%, or \$244 million, due to similar factors as those affecting the three month period discussed above. Sales of security products increased slightly and were driven in part by the relatively recent update of our firewall security product portfolio. We experienced a decrease in sales of Other Products due in large part to lower sales of Linksys home networking products and lower sales of other networking products.

Net Service Sales 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, 2013	January 28, 2012	Variance in Dollars	Variance in Percent	January 26, 2013	January 28, 2012	Variance in Dollars	Variance in Percent		
Net service sales:										
Americas	\$1,747	\$1,579	\$168	10.6 %	\$3,456	\$3,110	\$346	11.1 %		
Percentage of net service sales	65.7 %	65.6 %			66.0 %	66.0 %				
EMEA	546	502	44	8.8 %	1,055	976	79	8.1 %		
Percentage of net service sales	20.5 %	20.8 %			20.1 %	20.7 %				
APJC	368	328	40	12.2 %	729	627	102	16.3 %		
Percentage of net service sales	13.8 %	13.6 %			13.9 %	13.3 %				
Total	\$2,661	\$2,409	\$252	10.5 %	\$5,240	\$4,713	\$527	11.2 %		

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Service revenue experienced solid growth across all of our geographic segments for the second quarter. Worldwide technical support services revenue increased by 7%, and worldwide advanced services, which relate to consulting support services for specific network needs, experienced 20% revenue growth. Technical support services revenue grew across all of our geographic segments, with the Americas and APJC growing faster than the worldwide average, and EMEA growing slower than the worldwide average. Renewals and technical support service contract initiations associated with product sales provided an installed base of equipment being serviced which, in concert with new service offerings, were the primary factors driving these sales increases. Advanced services revenue had solid growth across all geographic segments. Advanced services revenue growth was driven by strong growth in both transaction and subscription revenues.

Six Months Ended January 26, 2013 Compared with Six Months Ended January 28, 2012

Service revenue experienced solid growth across all of our geographic segments for the period. Worldwide technical support services revenue increased by 8%, and worldwide advanced services experienced 22% revenue growth. Technical support services revenue grew across all of our geographic segments. Advanced services revenue also grew across all geographic segments, with particularly strong growth in APJC. Advanced services revenue growth was driven by strong growth in both transaction and subscription revenues.

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, 2013	January 28, 2012	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012	January 26, 2013	January 28, 2012		
Gross margin:										
Product	\$5,580	\$5,468	59.1 %	60.0 %	\$11,129	\$10,857	59.4 %	60.1 %		
Service	1,763	1,597	66.3 %	66.3 %	3,453	3,098	65.9 %	65.7 %		
Total	\$7,343	\$7,065	60.7 %	61.3 %	\$14,582	\$13,955	60.8 %	61.3 %		

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 2013 as compared with the corresponding prior year periods:

	Product Gross Margin Percentage			
	Three Months Ended		Six Months Ended ⁽¹⁾	
Fiscal 2012	60.0	%	60.1	%
Sales discounts, rebates, and product pricing	(2.6)	)%	(2.8))%
Mix of products sold	(0.4)	)%	(0.7))%
Amortization of purchased intangible assets	(0.5)	)%	(0.5))%
Acquisition fair value adjustment to inventory and other	(0.2)	)%	(0.2))%
Productivity ⁽²⁾	2.8	%	3.5	%
Fiscal 2013	59.1	%	59.4	%

⁽¹⁾ During the second quarter of fiscal 2013, we refined our methodology for presenting the items in the preceding table and accordingly certain reclassifications have been made to the six months ended amounts to conform to the presentation followed for the three months-ended amounts.

⁽²⁾ Productivity includes overall manufacturing-related costs, shipment volume, and other items not categorized elsewhere.

Three Months Ended January 26, 2013 Compared with Three Months Ended January 28, 2012

Product gross margin decreased by 0.9 percentage points for the period. The decrease was primarily due to the impact of higher sales discounts, rebates, and unfavorable product pricing, which were driven by normal market factors and by the geographic mix of net product sales. These factors impacted most of our customer markets and all of our geographic segments. Additionally, our product gross margin for the second quarter of fiscal 2013 was negatively impacted by the shift in the mix of pr