

CISCO SYSTEMS, INC.
Form 10-Q
November 20, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended October 27, 2018

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

For the transition period from _____ to _____
Commission file number 0-18225

CISCO SYSTEMS, INC.
(Exact name of registrant as specified in its charter)
California 77-0059951
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)
170 West Tasman Drive
San Jose, California 95134
(Address of principal executive office and zip code)
(408) 526-4000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company
Emerging growth company

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

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

Yes No

Number of shares of the registrant's common stock outstanding as of November 15, 2018: 4,495,961,730

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Cisco Systems, Inc.

Form 10-Q for the Quarter Ended October 27, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CISCO SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except par value)

(Unaudited)

	October 27, 2018	July 28, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,410	\$ 8,934
Investments	34,183	37,614
Accounts receivable, net of allowance for doubtful accounts of \$130 at October 27, 2018 and \$129 at July 28, 2018	4,536	5,554
Inventories	1,572	1,846
Financing receivables, net	4,851	4,949
Other current assets	2,134	2,940
Total current assets	55,686	61,837
Property and equipment, net	2,956	3,006
Financing receivables, net	4,644	4,882
Goodwill	33,386	31,706
Purchased intangible assets, net	2,716	2,552
Deferred tax assets	3,960	3,219
Other assets	2,081	1,582
TOTAL ASSETS	\$ 105,429	\$ 108,784
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	\$ 7,241	\$ 5,238
Accounts payable	1,805	1,904
Income taxes payable	1,084	1,004
Accrued compensation	2,622	2,986
Deferred revenue	9,637	11,490
Other current liabilities	4,025	4,413
Total current liabilities	26,414	27,035
Long-term debt	18,323	20,331
Income taxes payable	8,216	8,585
Deferred revenue	7,177	8,195
Other long-term liabilities	1,451	1,434
Total liabilities	61,581	65,580
Commitments and contingencies (Note 13)		
Equity:		
Cisco shareholders' equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	—	—
Common stock and additional paid-in capital, \$0.001 par value: 20,000 shares authorized; 4,517 and 4,614 shares issued and outstanding at October 27, 2018 and July 28, 2018, respectively	41,897	42,820
Retained earnings	3,169	1,233
Accumulated other comprehensive income (loss)	(1,218)	(849)
Total equity	43,848	43,204

TOTAL LIABILITIES AND EQUITY

\$ 105,429 \$ 108,784

See Notes to Consolidated Financial Statements.

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

	Three Months Ended	
	October 2018	October 2017
REVENUE:		
Product	\$9,890	\$ 9,054
Service	3,182	3,082
Total revenue	13,072	12,136
COST OF SALES:		
Product	3,799	3,615
Service	1,127	1,094
Total cost of sales	4,926	4,709
GROSS MARGIN	8,146	7,427
OPERATING EXPENSES:		
Research and development	1,608	1,567
Sales and marketing	2,410	2,334
General and administrative	211	557
Amortization of purchased intangible assets	34	61
Restructuring and other charges	78	152
Total operating expenses	4,341	4,671
OPERATING INCOME	3,805	2,756
Interest income	344	379
Interest expense	(221)	(235)
Other income (loss), net	(19)	62
Interest and other income (loss), net	104	206
INCOME BEFORE PROVISION FOR INCOME TAXES	3,909	2,962
Provision for income taxes	360	568
NET INCOME	\$3,549	\$ 2,394
Net income per share:		
Basic	\$0.78	\$ 0.48
Diluted	\$0.77	\$ 0.48
Shares used in per-share calculation:		
Basic	4,565	4,959
Diluted	4,614	4,994

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in millions)

(Unaudited)

	Three Months Ended	
	October 27, 2018	October 28, 2017
Net income	\$3,549	\$ 2,394
Available-for-sale investments:		
Change in net unrealized gains and losses, net of tax benefit (expense) of \$13 and \$(23) for the three months ended October 27, 2018 and October 28, 2017, respectively	5	(5)
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$0 and \$10 for the three months ended October 27, 2018 and October 28, 2017, respectively	6	(23)
	11	(28)
Cash flow hedging instruments:		
Change in unrealized gains and losses, net of tax benefit (expense) of \$1 and \$(1) for the three months ended October 27, 2018 and October 28, 2017, respectively	(3)	7
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$0 and \$2 for the three months ended October 27, 2018 and October 28, 2017, respectively	—	(11)
	(3)	(4)
Net change in cumulative translation adjustment and actuarial gains and losses net of tax benefit (expense) of \$(1) and \$(2) for the three months ended October 27, 2018 and October 28, 2017, respectively	(209)	17
Other comprehensive income (loss)	(201)	(15)
Comprehensive income (loss)	3,348	2,379
Comprehensive (income) loss attributable to noncontrolling interests	—	—
Comprehensive income (loss) attributable to Cisco Systems, Inc.	\$3,348	\$ 2,379
See Notes to Consolidated Financial Statements.		

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

	Three Months Ended	
	October 28, 2018	October 28, 2017
Cash flows from operating activities:		
Net income	\$3,549	\$ 2,394
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and other	465	566
Share-based compensation expense	403	392
Provision (benefit) for receivables	8	(17)
Deferred income taxes	(72)	178
(Gains) losses on divestitures, investments and other, net	7	(56)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	892	957
Inventories	(34)	(80)
Financing receivables	273	(333)
Other assets	(295)	8
Accounts payable	(153)	(235)
Income taxes, net	(437)	(419)
Accrued compensation	(348)	(215)
Deferred revenue	(309)	77
Other liabilities	(186)	(137)
Net cash provided by operating activities	3,763	3,080
Cash flows from investing activities:		
Purchases of investments	(484)	(8,275)
Proceeds from sales of investments	2,805	2,682
Proceeds from maturities of investments	2,541	3,929
Acquisition of businesses, net of cash and cash equivalents acquired	(1,964)	(725)
Purchases of investments in privately held companies	(29)	(20)
Return of investments in privately held companies	16	81
Acquisition of property and equipment	(212)	(168)
Proceeds from sales of property and equipment	2	1
Other	—	(10)
Net cash provided by (used in) investing activities	2,675	(2,505)
Cash flows from financing activities:		
Issuances of common stock	8	9
Repurchases of common stock—repurchase program	(5,076)	(1,686)
Shares repurchased for tax withholdings on vesting of restricted stock units	(318)	(342)
Short-term borrowings, original maturities of 90 days or less, net	—	(2,498)
Issuances of debt	—	5,482
Repayments of debt	—	(748)
Dividends paid	(1,500)	(1,436)
Other	(59)	(31)
Net cash used in financing activities	(6,945)	(1,250)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(507)	(675)

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Cash, cash equivalents, and restricted cash, beginning of period	8,993	11,773
Cash, cash equivalents, and restricted cash, end of period	\$8,486	\$ 11,098
Supplemental cash flow information:		
Cash paid for interest	\$269	\$ 283
Cash paid for income taxes, net	\$869	\$ 810

See Notes to Consolidated Financial Statements.

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

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT JULY 28, 2018	4,614	\$ 42,820	\$ 1,233	\$ (849)	\$ 43,204	\$	—\$43,204
Net income			3,549		3,549		3,549
Other comprehensive income (loss)				(201)	(201)		(201)
Issuance of common stock	19	8			8		8
Repurchase of common stock	(109)	(1,016)	(4,010)		(5,026)		(5,026)
Shares repurchased for tax withholdings on vesting of restricted stock units	(7)	(318)			(318)		(318)
Cash dividends declared (\$0.33 per common share)			(1,500)		(1,500)		(1,500)
Effect of adoption of accounting standards			3,897	(168)	3,729		3,729
Share-based compensation		403			403		403
BALANCE AT OCTOBER 27, 2018	4,517	\$ 41,897	\$ 3,169	\$ (1,218)	\$ 43,848	\$	—\$43,848

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Cisco Shareholders' Equity	Non-control- ling Interests	Total Equity
BALANCE AT JULY 29, 2017	4,983	\$ 45,253	\$ 20,838	\$ 46	\$ 66,137	\$	—\$66,137
Net income			2,394		2,394		2,394
Other comprehensive income (loss)				(15)	(15)	—	(15)
Issuance of common stock	30	9			9		9
Repurchase of common stock	(51)	(462)	(1,158)		(1,620)		(1,620)
Shares repurchased for tax withholdings on vesting of restricted stock units	(11)	(342)			(342)		(342)
Cash dividends declared (\$0.29 per common share)			(1,436)		(1,436)		(1,436)
Effect of adoption of accounting standards			9		9		9
Share-based compensation		392			392		392
Purchase acquisitions and other		22			22		22
BALANCE AT OCTOBER 28, 2017	4,951	\$ 44,872	\$ 20,647	\$ 31	\$ 65,550	\$	—\$65,550

See Notes to Consolidated Financial Statements.

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

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the “Company,” “Cisco,” “we,” “us,” or “our”) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2019 and fiscal 2018 are each 52-week fiscal years. The Consolidated Financial Statements include our accounts and those of our subsidiaries. All intercompany accounts and transactions have been eliminated. We conduct business globally and are primarily managed on a geographic basis in the following three geographic segments: the Americas; Europe, Middle East, and Africa (EMEA); and Asia Pacific, Japan, and China (APJC). We have prepared the accompanying financial data as of October 27, 2018 and for the three months ended October 27, 2018 and October 28, 2017, without audit, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The July 28, 2018 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, we believe that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended July 28, 2018.

We consolidate our investments in certain variable interest entities (VIEs) where we are the primary beneficiary. The noncontrolling interests attributed to these investments, if any, are presented as a separate component from our equity in the equity section of the Consolidated Balance Sheets. The share of earnings attributable to the noncontrolling interests are not presented separately in the Consolidated Statements of Operations as these amounts are not material for any of the fiscal periods presented.

In the opinion of management, all normal recurring adjustments necessary to present fairly the consolidated balance sheet as of October 27, 2018; the results of operations and the statements of comprehensive income (loss) for the three months ended October 27, 2018 and October 28, 2017; the statements of cash flows and equity for the three months ended October 27, 2018 and October 28, 2017, as applicable, have been made. The results of operations for the three months ended October 27, 2018 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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

2. Recent Accounting Pronouncements

(a) New Accounting Updates Recently Adopted

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

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

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

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

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

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

Significant Judgments

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

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

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

Our equity investments are accounted for as follows:

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

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

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

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

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

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

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

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

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

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Opening Balance Adjustments

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

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

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

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

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

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

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

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Impact of ASC 606 Adoption

The application of ASC 606 increased our total revenue by \$276 million in the first quarter of fiscal 2019. The application of ASC 606 did not have a material impact to either our cost of sales or our operating expenses in the first quarter of fiscal 2019. We recognized a \$152 million benefit to our provision for income taxes relating to indirect effects from the adoption of ASC 606 in the first quarter of fiscal 2019. For additional information regarding ASC 606, see Note 3 to the Consolidated Financial Statements.

In connection with the adoption of ASC 606, we recorded a transition adjustment to increase retained earnings by \$2.3 billion. See above for the transition impact of ASC 606 by balance sheet line item. As of October 27, 2018, the balance sheet changes attributable to ASC 606 related to accounts receivable, inventories, and deferred revenue were not materially different than the impacts upon adoption. In connection with the adoption of ASC 606, we established contract assets for unbilled receivables. As of October 27, 2018, we had total contract assets of \$447 million of which, \$270 million was recorded in other current assets and \$177 million was recorded in other assets. As of October 27, 2018, we had total capitalized contract acquisition costs of \$673 million, of which \$380 million was recorded in other current assets and \$293 million was recorded in other assets. The adoption of ASC 606 did not have any impact on net cash provided by operating activities.

(b) Recent Accounting Standards or Updates Not Yet Effective

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Revenue

(a) Disaggregation of Revenue

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

	Three Months Ended	
	October 2018	October 2017
Revenue:		
Infrastructure Platforms	\$7,642	\$ 6,980
Applications	1,419	1,203
Security	651	585
Other Products	178	286
Total Product	9,890	9,054
Services	3,182	3,082
Total	\$13,072	\$ 12,136

Amounts may not sum due to rounding.

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

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

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

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

In addition to our product offerings, we provide a broad range of service and support options for our customers, including technical support services and advanced services. Technical support services represent the majority of these offerings which are distinct performance obligations that are satisfied over time with revenue recognized ratably over the contract term. Advanced services are distinct performance obligations that are satisfied over time with revenue recognized as services are delivered.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(b) Contract Balances

Accounts receivable, net was \$4.5 billion as of October 27, 2018 compared to \$5.6 billion as of July 28, 2018, as reported on the Consolidated Balance Sheet.

Contract assets consist of unbilled receivables and are recorded when revenue is recognized in advance of scheduled billings to our customers. These amounts are primarily related to software and service arrangements where transfer of control has occurred but we have not yet invoiced. As of October 27, 2018 and July 29, 2018, our contract assets for these unbilled receivables were \$447 million and \$122 million, respectively, and were included in other current assets and other assets.

Contract liabilities consist of deferred revenue. Deferred revenue was \$16.8 billion as of October 27, 2018 compared to \$19.7 billion as of July 28, 2018. In connection with the adoption of ASC 606, we recorded an adjustment to retained earnings to reduce deferred revenue by \$2.8 billion. We recognized approximately \$3.4 billion of revenue during the first quarter of fiscal 2019 that was included in the deferred revenue balance at July 29, 2018.

(c) Remaining Performance Obligations

Remaining Performance Obligations (RPO) are comprised of deferred revenue plus unbilled contract revenue. As of October 27, 2018, the aggregate amount of RPO was \$22.3 billion, comprised of \$16.8 billion of deferred revenue and \$5.5 billion of unbilled contract revenue. We expect approximately 55% of this amount to be recognized as revenue over the next year. Unbilled contract revenue represents non-cancelable contracts for which we have not invoiced, have an obligation to perform, and revenue has not yet been recognized in the financial statements.

(d) Capitalized Contract Acquisition Costs

In connection with the adoption of ASC 606, we began to capitalize direct and incremental costs incurred to acquire contracts, primarily sales commissions, for which the associated revenue is expected to be recognized in future periods. We incur these costs in connection with both initial contracts and renewals. These costs are initially deferred and typically amortized over the term of the customer contract which corresponds to the period of benefit. Deferred sales commissions were \$673 million and \$644 million as of October 27, 2018 and July 29, 2018, respectively, and were included in other current assets and other assets. The amortization expense associated with these costs was \$112 million for the first quarter of fiscal 2019 and was included in sales and marketing expenses.

4. Acquisitions and Divestitures

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

	Purchase Consideration	Net Tangible Assets Acquired (Liabilities Assumed)	Purchased Intangible Assets	Goodwill
Duo	\$ 2,025	\$ (57)	\$ 342	\$ 1,740
Other (one acquisition)	34	3	8	23
Total	\$ 2,059	\$ (54)	\$ 350	\$ 1,763

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

acquisition has been included in our Security product category.

The total purchase consideration related to acquisitions completed during the first quarter of fiscal 2019 consisted of cash consideration and vested share-based awards assumed. The total cash and cash equivalents acquired from these acquisitions was approximately \$82 million. Total transaction costs related to acquisition and divestiture activities were \$10 million and \$9 million for the first quarter of fiscal 2019 and fiscal 2018, respectively. These transaction costs were expensed as incurred in general and administrative expenses ("G&A") in the Consolidated Statements of Operations. We recognized a gain of \$3 million and \$46 million during the first quarter of 2019 and fiscal 2018, respectively, in connection with step acquisitions. The gains were recognized in other income (loss), net in the Consolidated Statement of Operations.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The purchase price allocation for acquisitions completed during recent periods is preliminary and subject to revision as additional information about fair value of assets and liabilities becomes available. Additional information that existed as of the acquisition date but at that time was unknown to us may become known to us 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.

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

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

Divestiture of Service Provider Video Software Solutions On May 1, 2018, we announced a definitive agreement to sell our Service Provider Video Software Solutions ("SPVSS") business. As of October 27, 2018, this business had tangible assets of approximately \$165 million (primarily comprised of accounts receivables, inventories and various other current and long-term assets) and net intangible assets and goodwill (based on relative fair value) of \$330 million. In addition, the business had total liabilities of approximately \$290 million (primarily comprised of deferred revenue and various other current and long-term liabilities). These assets and liabilities were held for sale and were not presented separately as the amounts were not material to the Consolidated Balance Sheet. We closed the sale of this business on October 28, 2018 and the value is preliminary and subject to revision as information is finalized. We expect to have an immaterial financial statement impact from this transaction.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the goodwill allocated to our reportable segments as of October 27, 2018 and during the first quarter of fiscal 2019 (in millions):

	Balance at July 28, 2018	Acquisitions	Other	Balance at October 27, 2018
Americas	\$19,998	\$ 1,073	\$(53)	\$ 21,018
EMEA	7,529	491	(19)	8,001
APJC	4,179	199	(11)	4,367
Total	\$31,706	\$ 1,763	\$(83)	\$ 33,386

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

(b) Purchased Intangible Assets

The following table presents details of our intangible assets acquired through acquisitions completed during the first quarter of fiscal 2019 (in millions, except years):

	FINITE LIVES			INDEFINITE LIVES		TOTAL		
	TECHNOLOGY	CUSTOMER RELATIONSHIPS	OTHER	IPR&D				
	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount	Amount		
Duo	5.0	\$ 153	5.0	\$ 94	2.5	\$ 18	\$ 77	\$ 342
Others (one in total)	5.0	8	—	—	—	—	—	8
Total		\$ 161		\$ 94		\$ 18	\$ 77	\$ 350

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

October 27, 2018	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,847	\$(2,013)	\$1,834
Customer relationships	1,629	(965)	664
Other	80	(42)	38
Total purchased intangible assets with finite lives	5,556	(3,020)	2,536
In-process research and development, with indefinite lives	180	—	180
Total	\$5,736	\$(3,020)	\$2,716

July 28, 2018	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,711	\$(1,888)	\$1,823
Customer relationships	1,538	(937)	601
Other	63	(38)	25

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

	Three Months Ended October 27, 2018		October 27, 2017
Amortization of purchased intangible assets:			
Cost of sales	\$151	\$ 154	
Operating expenses	34	61	
Total	\$185	\$ 215	

The estimated future amortization expense of purchased intangible assets with finite lives as of October 27, 2018 is as follows (in millions):

Fiscal Year	Amount
2019 (remaining nine months)	\$ 577
2020	\$ 726
2021	\$ 530
2022	\$ 274
2023	\$ 133
Thereafter	\$ 45

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Restructuring and Other Charges

We initiated a restructuring plan during fiscal 2018 (the "Fiscal 2018 Plan") in order to realign the organization and enable further investment in key priority areas with estimated pretax charges of approximately \$300 million. In the first quarter of fiscal 2019, we expanded the restructuring plan to include an additional \$300 million of estimated additional pretax charges. In connection with the Fiscal 2018 Plan, we have incurred cumulative charges of \$186 million. These aggregate pretax charges are primarily cash-based and consist of employee severance and other one-time termination benefits, and other associated costs. We expect the Fiscal 2018 Plan to be substantially completed in fiscal 2019.

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

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

	FISCAL 2017 AND PRIOR PLANS		FISCAL 2018 PLAN		
	Employee Severance	Other	Employee Severance	Other	Total
Liability as of July 28, 2018	\$41	\$13	\$19	\$—	\$73
Charges	—	—	54	24	78
Cash payments	(10)	(1)	(52)	(1)	(64)
Non-cash items	—	—	—	(23)	(23)
Liability as of October 27, 2018	\$31	\$12	\$21	\$—	\$64

	FISCAL 2017 AND PRIOR PLANS		
	Employee Severance	Other	Total
Liability as of July 29, 2017	\$74	\$43	\$117
Charges	145	7	152
Cash payments	(79)	(16)	(95)
Non-cash items	—	(6)	(6)
Liability as of October 28, 2017	\$140	\$28	\$168

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Balance Sheet Details

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

	October 27, July 28,	
	2018	2018
Cash and cash equivalents	\$ 8,410	\$ 8,934
Restricted cash included in other current assets	32	32
Restricted cash included in other assets	44	27
Total cash, cash equivalents, and restricted cash	\$ 8,486	\$ 8,993
Inventories:		
Raw materials	\$421	\$423
Work in Process	—	—
Finished goods:		
Deferred cost of sales and distributor inventory	116	443
Manufactured finished goods	758	689
Total finished goods	874	1,132
Service-related spares	248	258
Demonstration systems	29	33
Total	\$1,572	\$1,846
Property and equipment, net:		
Gross property and equipment:		
Land, buildings, and building and leasehold improvements	\$4,707	\$4,710
Computer equipment and related software	1,037	1,085
Production, engineering, and other equipment	5,712	5,734
Operating lease assets	475	356
Furniture and fixtures	363	358
Total gross property and equipment	12,294	12,243
Less: accumulated depreciation and amortization	(9,338)	(9,237)
Total	\$2,956	\$3,006
Deferred revenue:		
Service	\$11,062	\$11,431
Product	5,752	8,254
Total	\$16,814	\$19,685
Reported as:		
Current	\$9,637	\$11,490
Noncurrent	7,177	8,195
Total	\$16,814	\$19,685

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CISCO SYSTEMS, INC.

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(Unaudited)

8. Financing Receivables and Operating Leases

(a) Financing Receivables

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

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

	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
October 27, 2018				
Gross	\$ 2,511	\$ 4,924	\$ 2,240	\$9,675
Residual value	159	—	—	159
Unearned income	(140)	—	—	(140)
Allowance for credit loss	(131)	(60)	(8)	(199)
Total, net	\$ 2,399	\$ 4,864	\$ 2,232	\$9,495
Reported as:				
Current	\$ 1,143	\$ 2,422	\$ 1,286	\$4,851
Noncurrent	1,256	2,442	946	4,644
Total, net	\$ 2,399	\$ 4,864	\$ 2,232	\$9,495
July 28, 2018				
Gross	\$ 2,688	\$ 4,999	\$ 2,326	\$10,013
Residual value	164	—	—	164
Unearned income	(141)	—	—	(141)
Allowance for credit loss	(135)	(60)	(10)	(205)
Total, net	\$ 2,576	\$ 4,939	\$ 2,316	\$9,831
Reported as:				
Current	\$ 1,249	\$ 2,376	\$ 1,324	\$4,949
Noncurrent	1,327	2,563	992	4,882
Total, net	\$ 2,576	\$ 4,939	\$ 2,316	\$9,831

Future minimum lease payments to Cisco on lease receivables as of October 27, 2018 are summarized as follows (in millions):

Fiscal Year	Amount
2019 (remaining nine months)	\$ 1,105
2020	614
2021	478
2022	231
2023	78

Thereafter	5
Total	\$ 2,511

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

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(Unaudited)

(b) Credit Quality of Financing Receivables

Gross receivables, excluding residual value, less unearned income categorized by our internal credit risk rating as of October 27, 2018 and July 28, 2018 are summarized as follows (in millions):

	INTERNAL CREDIT RISK RATING			Total
	1 to 4	5 to 6	7 and Higher	
October 27, 2018				
Lease receivables	\$1,238	\$1,084	\$ 49	\$2,371
Loan receivables	3,122	1,744	58	4,924
Financed service contracts	1,454	768	18	2,240
Total	\$5,814	\$3,596	\$ 125	\$9,535

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

We determine the adequacy of our allowance for credit loss by assessing the risks and losses inherent in our financing receivables by portfolio segment. The portfolio segment is based on the types of financing offered by us to our customers, which consist of the following: lease receivables, loan receivables, and financed service contracts. Our internal credit risk ratings of 1 through 4 correspond to investment-grade ratings, while credit risk ratings of 5 and 6 correspond to non-investment grade ratings. Credit risk ratings of 7 and higher correspond to substandard ratings. The following tables present the aging analysis of gross receivables, excluding residual value and less unearned income as of October 27, 2018 and July 28, 2018 (in millions):

	DAYS PAST DUE (INCLUDES BILLED AND UNBILLED)			Total Past Due	Current	Total	Nonaccrual Financing Receivables	Impaired Financing Receivables
	31-60	61-90	91+					
October 27, 2018								
Lease receivables	\$79	\$ 27	\$121	\$ 227	\$2,144	\$2,371	\$ 5	\$ 5
Loan receivables	123	85	348	556	4,368	4,924	29	29
Financed service contracts	102	147	262	511	1,729	2,240	3	3
Total	\$304	\$ 259	\$731	\$ 1,294	\$8,241	\$9,535	\$ 37	\$ 37

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

Past due financing receivables are those that are 31 days or more past due according to their contractual payment terms. The data in the preceding tables is presented by contract, and the aging classification of each contract is based on the oldest outstanding receivable, and therefore past due amounts also include unbilled and current receivables within the same contract. The balances of either unbilled or current financing receivables included in the category of 91 days plus past due for financing receivables were \$474 million and \$503 million as of October 27, 2018 and July 28, 2018, respectively.

As of October 27, 2018, we had financing receivables of \$234 million, net of unbilled or current receivables, that were in the category of 91 days plus past due but remained on accrual status as they are well secured and in the process of collection. Such balance was \$182 million as of July 28, 2018.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Allowance for Credit Loss Rollforward

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

Three months ended October 27, 2018	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 28, 2018	\$135	\$ 60	\$ 10	\$205
Provisions (benefits)	(3)	—	(2)	(5)
Foreign exchange and other	(1)	—	—	(1)
Allowance for credit loss as of October 27, 2018	\$131	\$ 60	\$ 8	\$199
Three months ended October 28, 2017	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts	Total
Allowance for credit loss as of July 29, 2017	\$162	\$ 103	\$ 30	\$295
Provisions	(2)	2	(6)	(6)
Foreign exchange and other	—	1	(1)	—
Allowance for credit loss as of October 28, 2017	\$160	\$ 106	\$ 23	\$289

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

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

Typically, we also consider receivables with a risk rating of 8 or higher to be impaired and will include them in the individual assessment for allowance. These balances, as of October 27, 2018 and July 28, 2018, are presented under "(b) Credit Quality of Financing Receivables" above.

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

(d) Operating Leases

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

	October 27, 2018	July 28, 2018
Operating lease assets	\$ 475	\$ 356
Accumulated depreciation	(333)	(238)
Operating lease assets, net	\$ 142	\$ 118

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Minimum future rentals on noncancelable operating leases as of October 27, 2018 are summarized as follows (in millions):

Fiscal Year	Amount
2019 (remaining nine months)	\$ 125
2020	108
2021	44
2022	3
Thereafter	1
Total	\$ 281

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

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

	October 27, July 28, 2018 2018	
Available-for-sale debt investments	\$ 34,183	\$37,009
Marketable equity securities	—	605
Total investments	34,183	37,614
Non-marketable equity securities included in other assets	1,125	978
Equity method investments included in other assets	115	118
Total	\$ 35,423	\$38,710

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

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

October 27, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government securities	\$ 5,783	\$ —	\$ (29)	\$5,754
U.S. government agency securities	434	—	(4)	430
Non-U.S. government and agency securities	153	—	—	153
Corporate debt securities	26,444	33	(446)	26,031
U.S. agency mortgage-backed securities	1,481	—	(60)	1,421
Commercial paper	309	—	—	309
Certificates of deposit	85	—	—	85
Total ⁽¹⁾	\$ 34,689	\$ 33	\$ (539)	\$34,183
July 28, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government securities	\$ 7,318	\$ —	\$ (43)	\$7,275
U.S. government agency securities	732	—	(5)	727
Non-U.S. government and agency securities	209	—	(1)	208
Corporate debt securities	27,765	44	(445)	27,364
U.S. agency mortgage-backed securities	1,488	—	(53)	1,435
Total ⁽¹⁾	\$ 37,512	\$ 44	\$ (547)	\$37,009

⁽¹⁾ Net unsettled investment purchases were \$1 million and net unsettled investment sales were \$1.5 billion as of October 27, 2018 and July 28, 2018, respectively and were included in other current assets and other current

liabilities.

Non-U.S. government and agency securities include agency and corporate debt securities that are guaranteed by non-U.S. governments.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	Three Months Ended October 27, 2018		October 28, 2017	
Gross realized gains	\$ 2	\$ 8		
Gross realized losses	(8)	(4)		
Total	\$ (6)	\$ 4		

The following tables present the breakdown of the available-for-sale debt investments with gross unrealized losses and the duration that those losses had been unrealized at October 27, 2018 and July 28, 2018 (in millions):

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 2 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
October 27, 2018						
U.S. government securities	\$ 516	\$ (3)	\$ 5,231	\$ (26)	\$ 5,747	\$ (29)
U.S. government agency securities	4	—	427	(4)	431	(4)
Non-U.S. government and agency securities	—	—	153	—	153	—
Corporate debt securities	13,483	(257)	6,738	(189)	20,221	(446)
U.S. agency mortgage-backed securities	456	(12)	947	(48)	1,403	(60)
Total	\$ 14,459	\$ (272)	\$ 13,496	\$ (267)	\$ 27,955	\$ (539)

	UNREALIZED LOSSES LESS THAN 12 MONTHS		UNREALIZED LOSSES 2 MONTHS OR GREATER		TOTAL	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
July 28, 2018						
U.S. government securities	\$ 2,966	\$ (20)	\$ 4,303	\$ (23)	\$ 7,269	\$ (43)
U.S. government agency securities	206	(2)	521	(3)	727	(5)
Non-U.S. government and agency securities	105	(1)	103	—	208	(1)
Corporate debt securities	16,990	(344)	3,511	(101)	20,501	(445)
U.S. agency mortgage-backed securities	826	(24)	581	(29)	1,407	(53)
Total	\$ 21,093	\$ (391)	\$ 9,019	\$ (156)	\$ 30,112	\$ (547)

During the first quarter of fiscal 2019 and fiscal 2018, respectively, we did not recognize any impairment charges on our available-for-sale debt investments. For available-for-sale debt investments that were in an unrealized loss position as of October 27, 2018, we have determined that no other-than-temporary impairments were required to be recognized.

The following table summarizes the maturities of our available-for-sale debt investments as of October 27, 2018 (in millions):

	Amortized Cost	Fair Value
Within 1 year	\$ 12,283	\$ 12,243
After 1 year through 5 years	19,248	18,922

After 5 years through 10 years	1,662	1,581
After 10 years	15	16
Mortgage-backed securities with no single maturity	1,481	1,421
Total	\$ 34,689	\$ 34,183

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(b) Summary of Equity Investments

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

	Three Months Ended October 27, 2018
Adjustments to non-marketable equity securities measured using the measurement alternative:	
Upward adjustments	\$ 10
Downward adjustments, including impairments	(16)
Net downward adjustments	\$ (6)
Gains and losses recognized on our marketable and non-marketable equity securities for the first quarter of fiscal 2019 are summarized below (in millions):	

	Three Months Ended October 27, 2018
Net gains and losses recognized during the period on equity investments	\$ 8
Less: Net gains and losses recognized on equity investments sold	(12)
Unrealized gains and losses recognized during reporting period on equity securities still held at the reporting date	\$ (4)

(c) Securities Lending

We periodically engage in securities lending activities with certain of our available-for-sale debt investments. These transactions are accounted for as a secured lending of the securities, and the securities are typically loaned only on an overnight basis. The average daily balance of securities lending was \$0.5 billion as of each of the first quarters of fiscal 2019 and fiscal 2018, respectively. We require collateral equal to at least 102% of the fair market value of the loaned security and that the collateral be in the form of cash or liquid, high-quality assets. We engage in these secured lending transactions only with highly creditworthy counterparties, and the associated portfolio custodian has agreed to indemnify us against collateral losses. We did not experience any losses in connection with the secured lending of securities during the periods presented. As of October 27, 2018 and July 28, 2018, we had no outstanding securities lending transactions.

(d) Variable Interest Entities

In the ordinary course of business, we have investments in privately held companies and provide financing to certain customers. These privately held companies and customers may be considered to be variable interest entities. We evaluate on an ongoing basis our investments in these privately held companies and our customer financings, and have determined that as of October 27, 2018, except as disclosed in Note 1, there were no significant variable interest entities required to be consolidated in our Consolidated Financial Statements.

As of October 27, 2018, the carrying value of our non-marketable equity securities was \$1.2 billion, of which \$670 million of such investments are considered to be in variable interest entities which are unconsolidated. In addition, we have additional funding commitments of \$204 million related to these investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The

carrying value of these investments and the additional funding commitments collectively represent our maximum exposure related to these variable interest entities.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

10. Fair Value

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

(a) Fair Value Hierarchy

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

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

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

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

	OCTOBER 27, 2018			JULY 28, 2018		
	FAIR VALUE			FAIR VALUE		
	MEASUREMENTS			MEASUREMENTS		
	Level 1	Level 2	Total Balance	Level 1	Level 2	Total Balance
Assets:						
Cash equivalents:						
Money market funds	\$6,332	\$—	\$6,332	\$6,890	\$—	\$6,890
Commercial paper	—	210	210	—	—	—
Certificates of deposit	—	20	20	—	—	—
Repurchase agreements	—	16	16	—	—	—
Available-for-sale debt investments:						
U.S. government securities	—	5,754	5,754	—	7,275	7,275
U.S. government agency securities	—	430	430	—	727	727
Non-U.S. government and agency securities	—	153	153	—	208	208
Corporate debt securities	—	26,031	26,031	—	27,364	27,364
U.S. agency mortgage-backed securities	—	1,421	1,421	—	1,435	1,435
Commercial paper	—	309	309	—	—	—
Certificates of deposit	—	85	85	—	—	—
Equity investments:						
Marketable equity securities	—	—	—	605	—	605
Derivative assets	—	6	6	—	2	2
Total	\$6,332	\$34,435	\$40,767	\$7,495	\$37,011	\$44,506
Liabilities:						
Derivative liabilities	\$—	\$91	\$91	\$—	\$74	\$74
Total	\$—	\$91	\$91	\$—	\$74	\$74

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

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

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

TOTAL
GAINS

(LOSSES)
FOR THE
THREE
MONTHS
ENDED
October
27, 28,
2018 2017

Non-marketable equity securities \$(6) \$(21)

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(d) Other Fair Value Disclosures

The fair value of short-term loan receivables and financed service contracts approximates their carrying value due to their short duration. The aggregate carrying value of long-term loan receivables and financed service contracts as of October 27, 2018 and July 28, 2018 was \$3.4 billion and \$3.6 billion, respectively. The estimated fair value of long-term loan receivables and financed service contracts approximates their carrying value. We use significant unobservable inputs in determining discounted cash flows to estimate the fair value of our long-term loan receivables and financed service contracts, and therefore they are categorized as Level 3.

As of October 27, 2018, the estimated fair value of our short-term debt approximates its carrying value due to the short maturities. As of October 27, 2018, the fair value of our senior notes and other long-term debt was \$26.2 billion with a carrying amount of \$25.6 billion. This compares to a fair value of \$26.4 billion and a carrying amount of \$25.6 billion as of July 28, 2018. The fair value of the senior notes and other long-term debt was determined based on observable market prices in a less active market and was categorized as Level 2 in the fair value hierarchy.

11. Borrowings

(a) Short-Term Debt

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

	October 27, 2018		July 28, 2018	
	Amount	Effective Rate	Amount	Effective Rate
Current portion of long-term debt	\$7,241	3.06 %	\$5,238	3.46 %

We have a short-term debt financing program of up to \$10.0 billion through the issuance of commercial paper notes. We use the proceeds from the issuance of commercial paper notes for general corporate purposes. We had no commercial paper notes outstanding as of October 27, 2018 and July 28, 2018.

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Long-Term Debt

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

	Maturity Date	October 27, 2018		July 28, 2018	
		Amount	Effective Rate	Amount	Effective Rate
Senior notes:					
Floating-rate notes:					
Three-month LIBOR plus 0.50%	March 1, 2019	\$ 500	2.88%	\$ 500	2.86%
Three-month LIBOR plus 0.34%	September 20, 2019	500	2.72%	500	2.71%
Fixed-rate notes:					
4.95%	February 15, 2019	2,000	5.22%	2,000	5.17%
1.60%	February 28, 2019	1,000	1.67%	1,000	1.67%
2.125%	March 1, 2019	1,750	2.87%	1,750	2.71%
1.40%	September 20, 2019	1,500	1.48%	1,500	1.48%
4.45%	January 15, 2020	2,500	4.68%	2,500	4.52%
2.45%	June 15, 2020	1,500	2.54%	1,500	2.54%
2.20%	February 28, 2021	2,500	2.30%	2,500	2.30%
2.90%	March 4, 2021	500	3.05%	500	2.86%
1.85%	September 20, 2021	2,000	1.90%	2,000	1.90%
3.00%	June 15, 2022	500	3.32%	500	3.11%
2.60%	February 28, 2023	500	2.68%	500	2.68%
2.20%	September 20, 2023	750	2.27%	750	2.27%
3.625%	March 4, 2024	1,000	3.17%	1,000	2.98%
3.50%	June 15, 2025	500	3.48%	500	3.27%
2.95%	February 28, 2026	750	3.01%	750	3.01%
2.50%	September 20, 2026	1,500	2.55%	1,500	2.55%
5.90%	February 15, 2039	2,000	6.11%	2,000	6.11%
5.50%	January 15, 2040	2,000	5.67%	2,000	5.67%
Total		25,750		25,750	
Unaccreted discount/issuance costs		(112)		(116)	
Hedge accounting fair value adjustments		(74)		(65)	
Total		\$25,564		\$25,569	

Reported as:

Current portion of long-term debt	\$7,241	\$5,238
Long-term debt	18,323	20,331
Total	\$25,564	\$25,569

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

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

debt financing program, as discussed above under “(a) Short-Term Debt.” As of October 27, 2018, we were in compliance with all debt covenants.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of October 27, 2018, future principal payments for long-term debt, including the current portion, are summarized as follows (in millions):

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

(c) Credit Facility

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

This credit agreement requires that we comply with certain covenants, including that we maintain an interest coverage ratio as defined in the agreement. As of October 27, 2018, we were in compliance with the required interest coverage ratio and the other covenants, and we had not borrowed any funds under this credit facility.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Derivative Instruments

(a) Summary of Derivative Instruments

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

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

	DERIVATIVE ASSETS		DERIVATIVE LIABILITIES			
	Balance Sheet Line Item	October 27, 2018	October 28, 2018	Balance Sheet Line Item	October 27, 2018	October 28, 2018
Derivatives designated as hedging instruments:						
Foreign currency derivatives	Other current assets	\$ 4	\$ 1	Other current liabilities	\$ 6	\$ —
Interest rate derivatives	Other current assets	—	—	Other current liabilities	7	10
Interest rate derivatives	Other assets	—	—	Other long-term liabilities	74	62
Total		4	1		87	72
Derivatives not designated as hedging instruments:						
Foreign currency derivatives	Other current assets	1	1	Other current liabilities	4	2
Total return swaps—deferred compensation	Other current assets	1	—	Other current liabilities	—	—
Total		2	1		4	2
Total		\$ 6	\$ 2		\$ 91	\$ 74

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

	GAINS (LOSSES) RECOGNIZED IN OCI ON DERIVATIVES FOR THE THREE MONTHS ENDED (EFFECTIVE PORTION)		Line Item in Statements of Operations	GAINS (LOSSES) RECLASSIFIED FROM AOCI INTO INCOME FOR THE THREE MONTHS ENDED (EFFECTIVE PORTION)	
	October 27, 2018	October 28, 2017		October 27, 2018	October 28, 2017
Derivatives designated as cash flow hedging instruments:					
Foreign currency derivatives	\$ (4)	\$ 8	Revenue — service	\$ 1	\$ —
			Operating expenses	(1)	10
			Cost of sales — service—		3
Total	\$ (4)	\$ 8		\$ —	\$ 13

Derivatives designated as net investment hedging instruments:

Foreign currency derivatives	\$ 4	\$ (5)	Other income (loss), net	\$ —	\$ —
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As of October 27, 2018, we estimate that approximately \$3 million of net derivative losses related to our cash flow hedges included in accumulated other comprehensive income (AOCI) will be reclassified into earnings within the next 12 months when the underlying hedged item impacts earnings.

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(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):

		GAINS (LOSSES) ON DERIVATIVE INSTRUMENTS FOR THE THREE MONTHS ENDED		GAINS (LOSSES) RELATED TO HEDGED ITEMS FOR THE THREE MONTHS ENDED	
Derivatives Designated as Fair Value Hedging Instruments	Line Item in Statements of Operations	October 27, 2018	October 28, 2017	October 27, 2018	October 28, 2017
Interest rate derivatives	Interest expense	\$ (9)	\$ (46)	\$ 9	\$ 46
Equity derivatives	Other income (loss), net	—	(14)	—	14
Total		\$ (9)	\$ (60)	\$ 9	\$ 60

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

		GAINS (LOSSES) FOR THE THREE MONTHS ENDED	
Derivatives Not Designated as Hedging Instruments	Line Item in Statements of Operations	October 27, 2018	October 28, 2017
Foreign currency derivatives	Other income (loss), net	\$ (27)	\$ 7
Total return swaps—deferred compensation	Operating expenses	(24)	15
	Cost of sales — product	(1)	—
	Cost of sales — service	(1)	1
	Other income (loss), net	(4)	(2)
Equity derivatives	Other income (loss), net	1	1
Total		\$ (56)	\$ 22

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

	October 27, 2018	July 28, 2018
Derivatives designated as hedging instruments:		
Foreign currency derivatives—cash flow hedges	\$ 796	\$ 147
Interest rate derivatives	6,750	6,750
Net investment hedging instruments	246	250
Derivatives not designated as hedging instruments:		
Foreign currency derivatives	2,170	2,298
Total return swaps—deferred compensation	564	566
Total	\$ 10,526	\$ 10,011

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Offsetting of Derivative Instruments

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

October 27, 2018

	GROSS AMOUNTS NOT OFFSET IN THE CONSOLIDATED BALANCE SHEETS BUT WITH LEGAL RIGHTS TO OFFSET					
	Gross Amounts Recognized	Net Amounts Presented	Gross Derivative Amounts	Cash Collateral	Net Amount	
Derivatives assets	\$6	\$ —	\$ 6	\$ (5)	\$ —	\$ 1
Derivatives liabilities	\$91	\$ —	\$ 91	\$ (5)	\$ (70)	\$ 16

July 28, 2018

	GROSS AMOUNTS NOT OFFSET IN THE CONSOLIDATED BALANCE SHEETS BUT WITH LEGAL RIGHTS TO OFFSET					
	Gross Amounts Recognized	Net Amounts Presented	Gross Derivative Amounts	Cash Collateral	Net Amount	
Derivatives assets	\$2	\$ —	\$ 2	\$ (2)	\$ —	\$ —
Derivatives liabilities	\$74	\$ —	\$ 74	\$ (2)	\$ (53)	\$ 19

(c) Foreign Currency Exchange Risk

We conduct business globally in numerous currencies. Therefore, we are exposed to adverse movements in foreign currency exchange rates. To limit the exposure related to foreign currency changes, we enter into foreign currency contracts. We do not enter into such contracts for speculative purposes.

We hedge forecasted foreign currency transactions related to certain revenues, operating expenses and service cost of sales with currency options and forward contracts. These currency options and forward contracts, designated as cash flow hedges, generally have maturities of less than 24 months. We assess effectiveness based on changes in total fair value of the derivatives. The effective portion of the derivative instrument's gain or loss is initially reported as a component of AOCI and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion, if any, of the gain or loss is reported in earnings immediately. During the periods presented, we did not discontinue any cash flow hedges for which it was probable that a forecasted transaction would not occur. We enter into foreign exchange forward and option contracts to reduce the short-term effects of foreign currency fluctuations on assets and liabilities such as foreign currency receivables, including long-term customer financings, investments, and payables. These derivatives are not designated as hedging instruments. Gains and losses on the

contracts are included in other income (loss), net, and substantially offset foreign exchange gains and losses from the remeasurement of intercompany balances or other current assets, investments, or liabilities denominated in currencies other than the functional currency of the reporting entity.

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

(d) Interest Rate Risk

Interest Rate Derivatives, Investments Our primary objective for holding available-for-sale debt investments is to achieve an appropriate investment return consistent with preserving principal and managing risk. To realize these objectives, we may utilize interest rate swaps or other derivatives designated as fair value or cash flow hedges. As of October 27, 2018 and July 28, 2018, we did not have any outstanding interest rate derivatives related to our available-for-sale debt investments.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(e) Equity Price Risk

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

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

(f) Hedge Effectiveness

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

13. Commitments and Contingencies**(a) Operating Leases**

We lease office space in many U.S. locations. Outside the United States, larger leased sites include sites in Belgium, Canada, China, Germany, India, Israel, Japan, Mexico, Poland and the United Kingdom. We also lease equipment and vehicles. Future minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of October 27, 2018 are as follows (in millions):

Fiscal Year	Amount
2019 (remaining nine months)	\$ 312
2020	323
2021	220
2022	152
2023	102
Thereafter	116
Total	\$ 1,225

(b) Purchase Commitments with Contract Manufacturers and Suppliers

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

firm, noncancelable, and unconditional commitments. Certain of these purchase commitments with contract manufacturers and suppliers relate to arrangements to secure long-term pricing for certain product components for multi-year periods. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Commitments by Period	October 27, July 28, 2018 2018	
	Less than 1 year	\$ 5,500
1 to 3 years	704	710
3 to 5 years	270	360
Total	\$ 6,474	\$ 6,477

We record a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of our future demand forecasts consistent with the valuation of our excess and obsolete inventory. As of October 27, 2018 and July 28, 2018, the liability for these purchase commitments was \$150 million and \$159 million, respectively, and was included in other current liabilities.

(c) Other Commitments

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

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

	Three Months Ended October 27, October 28, 2018 2017	
	Compensation expense related to acquisitions	\$ 109

As of October 27, 2018, we estimated that future cash compensation expense of up to \$585 million may be required to be recognized pursuant to the applicable business combination agreements.

We also have certain funding commitments, primarily related to our non-marketable equity and other investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The funding commitments were \$378 million and \$223 million as of October 27, 2018 and July 28, 2018, respectively.

(d) Product Warranties

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

	Three Months Ended October 27, October 28, 2018 2017	
	Balance at beginning of period	\$ 359
Provisions for warranties issued	156	148
Adjustments for pre-existing warranties	(3)	(12)
Settlements	(145)	(149)
Balance at end of period	\$ 367	\$ 394

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

(e) Financing and Other Guarantees

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Channel Partner Financing Guarantees We facilitate arrangements for third-party financing extended to channel partners, consisting of revolving short-term financing, generally with payment terms ranging from 60 to 90 days. These financing arrangements facilitate the working capital requirements of the channel partners, and, in some cases, we guarantee a portion of these arrangements. The volume of channel partner financing was \$7.2 billion and \$6.7 billion for the first quarter of fiscal 2019 and fiscal 2018, respectively. The balance of the channel partner financing subject to guarantees was \$931 million and \$953 million as of October 27, 2018 and July 28, 2018, respectively.

End-User Financing Guarantees We also provide financing guarantees for third-party financing arrangements extended to end-user customers related to leases and loans, which typically have terms of up to three years. The volume of financing provided by third parties for leases and loans as to which we had provided guarantees was \$3 million and \$14 million for the first quarter of fiscal 2019 and fiscal 2018, respectively.

Financing Guarantee Summary The aggregate amounts of financing guarantees outstanding at October 27, 2018 and July 28, 2018, representing the total maximum potential future payments under financing arrangements with third parties along with the related deferred revenue, are summarized in the following table (in millions):

	October 27, 2018	July 28, 2018
Maximum potential future payments relating to financing guarantees:		
Channel partner	\$ 307	\$ 277
End user	28	31
Total	\$ 335	\$ 308
Deferred revenue associated with financing guarantees:		
Channel partner	\$ (72)	\$ (94)
End user	(26)	(28)
Total	\$ (98)	\$ (122)
Maximum potential future payments relating to financing guarantees, net of associated deferred revenue	\$ 237	\$ 186

Other Guarantees Our other guarantee arrangements as of October 27, 2018 and July 28, 2018 that were subject to recognition and disclosure requirements were not material.

(f) Indemnifications

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

We have been asked to indemnify Time Warner Cable (“TWC”) for patent infringement claims asserted against it by Sprint Communications Company, L.P. (“Sprint”) in federal court in Kansas. Sprint alleges that TWC infringed certain Sprint patents by offering VoIP telephone services utilizing products provided by us generally in combination with those of other manufacturers. Sprint seeks monetary damages. Following a trial on March 3, 2017, a jury in Kansas found that TWC willfully infringed five Sprint patents and awarded Sprint \$139.8 million in damages. On March 14, 2017, the Kansas court declined Sprint's request for enhanced damages and entered judgment in favor of Sprint for \$139.8 million plus 1.06% in post-judgment interest. On May 30, 2017, the Court awarded Sprint \$20.3 million in pre-judgment interest and denied TWC's post-trial motions. TWC has appealed to the U.S. Court of Appeals for the Federal Circuit. We believe that TWC continues to have strong non-infringement and invalidity defenses and arguments and/or that Sprint's damages claims are inconsistent with prevailing law. Due to the uncertainty surrounding the litigation process, we are unable to reasonably estimate the ultimate outcome of the TWC litigation at this time. Should Sprint prevail in litigation, or TWC agree to a settlement, we, in accordance with our agreements, may have an

obligation to indemnify TWC for damages, mediation awards, or settlement amounts arising from its use of our products. At this time, we do not anticipate that our obligations regarding the final outcome would be material. During the first quarter of fiscal 2018, we recorded legal and indemnification settlement charges of \$122 million to product cost of sales related to these and other matters.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(g) Legal Proceedings

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

The asserted claims by Brazilian federal tax authorities that remain are for calendar years 2003 through 2007, and the asserted claims by the tax authorities from the state of Sao Paulo are for calendar years 2005 through 2007. The total asserted claims by Brazilian state and federal tax authorities aggregate to \$221 million for the alleged evasion of import and other taxes, \$1.4 billion for interest, and \$1.0 billion for various penalties, all determined using an exchange rate as of October 27, 2018. We have completed a thorough review of the matters and believe the asserted claims against our Brazilian subsidiary are without merit, and we are defending the claims vigorously. While we believe there is no legal basis for the alleged liability, due to the complexities and uncertainty surrounding the judicial process in Brazil and the nature of the claims asserting joint liability with the importer, we are unable to determine the likelihood of an unfavorable outcome against our Brazilian subsidiary and are unable to reasonably estimate a range of loss, if any. We do not expect a final judicial determination for several years.

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

Straight Path On September 24, 2014, Straight Path IP Group, Inc. (“Straight Path”) asserted patent infringement claims against us in the U.S. District Court for the Northern District of California, accusing our 9971 IP Phone, Unified Communications Manager working in conjunction with 9971 IP Phones, and Video Communication Server products of infringement. All of the asserted patents have expired and Straight Path was therefore limited to seeking monetary damages for the alleged past infringement. On November 13, 2017, the Court granted our motion for summary judgment of non-infringement, thereby dismissing Straight Path’s claims against us and cancelling a trial which had been set for March 12, 2018. On January 16, 2018, Straight Path appealed to the U.S. Court of Appeal for the Federal Circuit.

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

Oyster Optics On November 24, 2016, Oyster Optics, LLC (“Oyster”) asserted patent infringement claims against us in the U.S. District Court for the Eastern District of Texas. Oyster alleges that certain Cisco ONS 15454 and NCS

2000 line cards infringe U.S. Patent No. 7,620,327 (“the ‘327 Patent”). Oyster seeks monetary damages. Oyster filed infringement claims based on the ‘327 Patent against other defendants, including ZTE, Nokia, NEC, Infinera, Huawei, Ciena, Alcatel-Lucent, and Fujitsu, and the court consolidated the cases alleging infringement of the ‘327 Patent. Oyster's cases against some of the defendants were resolved. The court vacated the November 4, 2018 trial date set for Oyster's claims against Cisco and one other remaining defendant, pending resolution of Oyster's appeal of the court's summary judgment ruling dismissing certain of Oyster's claims. While we believe that we have strong non-infringement arguments and that the patent is invalid, if we do not prevail in the District Court, we believe damages ultimately assessed would not be material. Due to uncertainty surrounding patent litigation processes, we are unable to reasonably estimate the ultimate outcome of this litigation at this time. However, we do not anticipate that any final outcome of the dispute would be material.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

14. Shareholders’ Equity

(a) Cash Dividends on Shares of Common Stock

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

Any future dividends will be subject to the approval of our Board of Directors.

(b) Stock Repurchase Program

In September 2001, our Board of Directors authorized a stock repurchase program. On February 14, 2018, our Board of Directors authorized a \$25 billion increase to the stock repurchase program. As of October 27, 2018, the remaining authorized amount for stock repurchases under this program, including the additional authorization, is approximately \$14.0 billion, with no termination date. A summary of the stock repurchase activity for fiscal year 2018 and 2017 under the stock repurchase program, reported based on the trade date, is summarized as follows (in millions, except per-share amounts):

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

There were \$130 million and \$180 million of stock repurchases that were pending settlement as of October 27, 2018 and July 28, 2018, respectively.

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

(c) Restricted Stock Unit Withholdings

We repurchased approximately 7 million and 11 million shares, or \$318 million and \$342 million, of common stock in settlement of employee tax withholding obligations due upon the vesting of restricted stock or stock units for each of the first quarter of fiscal 2019 and fiscal 2018, respectively.

(d) Preferred Stock

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

15. Employee Benefit Plans

(a) Employee Stock Incentive Plans

Stock Incentive Plan Program Description As of October 27, 2018, we had one stock incentive plan: the 2005 Stock Incentive Plan (the “2005 Plan”). In addition, we have, in connection with our acquisitions of various companies, assumed the share-based awards granted under stock incentive plans of the acquired companies or issued share-based awards in replacement thereof. Share-based awards are designed to reward employees for their long-term contributions to us and provide incentives for them to remain with Cisco. The number and frequency of share-based awards are based on competitive practices, operating results of Cisco, government regulations, and other factors. Our primary stock incentive plan is summarized as follows:

2005 Plan As of October 27, 2018, the maximum number of shares issuable under the 2005 Plan over its term was 694 million shares, plus shares from certain previous plans that are forfeited or are terminated for any other reason before being exercised or settled. If any awards granted under the 2005 Plan are forfeited or are terminated for any other reason before being exercised or settled, the unexercised or unsettled shares underlying the awards will again be available under the 2005 Plan. In addition, starting November 19, 2013, shares withheld by Cisco from an award other than a stock option or stock appreciation right to satisfy withholding tax liabilities resulting from such award will again be available for issuance, based on the fungible share ratio in effect on the date of grant.

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

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

(b) Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan, which includes its subplan named the International Employee Stock Purchase Plan (together, the “Purchase Plan”), under which 621 million shares of our common stock have been reserved for issuance as of October 27, 2018. Eligible employees are offered shares through a 24-month offering period, which consists of four consecutive 6-month purchase periods. Employees may purchase a limited number of shares of our stock at a discount of up to 15% of the lesser of the market value at the beginning of the offering period or the end of

each 6-month purchase period. The Purchase Plan is scheduled to terminate on January 3, 2020. No shares were issued under the Purchase Plan during each of the first quarter of fiscal 2019 and fiscal 2018. As of October 27, 2018, 78 million shares were available for issuance under the Purchase Plan.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Summary of Share-Based Compensation Expense

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

	Three Months Ended	
	October 27, 2018	October 28, 2017
Cost of sales—product	\$23	\$ 23
Cost of sales—service	33	34
Share-based compensation expense in cost of sales	56	57
Research and development	130	136
Sales and marketing	137	135
General and administrative	62	64
Restructuring and other charges	23	6
Share-based compensation expense in operating expenses	352	341
Total share-based compensation expense	\$408	\$ 398
Income tax benefit for share-based compensation	\$165	\$ 175

As of October 27, 2018, the total compensation cost related to unvested share-based awards not yet recognized was \$3.0 billion which is expected to be recognized over approximately 2.6 years on a weighted-average basis.

(d) Share-Based Awards Available for Grant

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

	Share-Based Awards Available for Grant
BALANCE AT JULY 29, 2017	272
Restricted stock, stock units, and other share-based awards granted	(70)
Share-based awards canceled/forfeited/expired	18
Shares withheld for taxes and not issued	25
BALANCE AT JULY 28, 2018	245
Restricted stock, stock units, and other share-based awards granted	(12)
Share-based awards canceled/forfeited/expired	5
Shares withheld for taxes and not issued	9
Other	1
BALANCE AT OCTOBER 27, 2018	248

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(e) Restricted Stock and Stock Unit Awards

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

	Restricted Stock/ Stock Units	Weighted-Average Grant Date Fair Value per Share	Aggregate Fair Value
UNVESTED BALANCE AT JULY 29, 2017	141	\$ 26.94	
Granted	46	35.62	
Assumed from acquisitions	1	28.26	
Vested	(53)	26.02	\$ 1,909
Canceled/forfeited/other	(16)	28.37	
UNVESTED BALANCE AT JULY 28, 2018	119	30.56	
Granted	8	45.05	
Vested	(19)	25.92	\$ 883
Canceled/forfeited/other	(4)	30.33	
UNVESTED BALANCE AT OCTOBER 27, 2018	104	\$ 32.48	

(f) Stock Option Awards

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

	STOCK OPTIONS OUTSTANDING	
	Number Outstanding	Weighted-Average Exercise Price per Share
BALANCE AT JULY 29, 2017	12	\$ 6.15
Assumed from acquisitions	3	8.20
Exercised	(8)	5.77
Canceled/forfeited/expired	(1)	8.75
BALANCE AT JULY 28, 2018	6	7.18
Exercised	(1)	6.50
BALANCE AT OCTOBER 27, 2018	5	\$ 7.29

The following table summarizes significant ranges of outstanding and exercisable stock options as of October 27, 2018 (in millions, except years and share prices):

Range of Exercise Prices	STOCK OPTIONS OUTSTANDING			STOCK OPTIONS EXERCISABLE		
	Number Outstanding	Weighted- Average Exercise Price per Share	Aggregate Intrinsic Value	Number Exercisable	Weighted- Average Exercise Price per Share	Aggregate Intrinsic Value
\$ 0.01 – 35.00	5.8	\$ 7.29	\$ 195	4	\$ 7.06	\$ 140

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on our closing stock price of \$44.25 as of October 26, 2018. The total number of in-the-money stock options exercisable as of October 27, 2018 was 4 million. As of July 28, 2018, 4 million outstanding stock options were exercisable and the weighted-average exercise price was \$6.84.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(g) Valuation of Employee Share-Based Awards

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

	RESTRICTED STOCK UNITS		PERFORMANCE BASED RESTRICTED STOCK UNITS	
Three Months Ended	October 27, 2018	October 28, 2017	October 27, 2018	October 28, 2017
Number of shares granted (in millions)	6	7	2	3
Grant date fair value per share	\$44.32	\$ 29.81	\$47.00	\$ 31.31
Weighted-average assumptions/inputs:				
Expected dividend yield	2.8 %	3.6 %	2.8 %	3.6 %
Range of risk-free interest rates	2.1% – 2.9%	1.0% – 1.9%	2.1% – 3.0%	1.0%-1.6%
Range of expected volatilities for index	N/A	N/A	13.0% – 65.2%	13.2%-81.0%

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

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

16. Comprehensive Income (Loss)

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

	Net Unrealized Gains (Losses) on Available-for-Sale Investments	Net Unrealized Gains (Losses) on Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Actuarial Gains (Losses)	Accumulated Other Comprehensive Income (Loss)
BALANCE AT JULY 28, 2018	\$ (310)	\$ (11)	\$ (528)	\$ (849)
Other comprehensive income (loss) before reclassifications attributable to Cisco Systems, Inc.	(8)	(4)	(207)	(219)
(Gains) losses reclassified out of AOCI	6	—	(1)	5
Tax benefit (expense)	13	1	(1)	13
Total change for the period	11	(3)	(209)	(201)
Effect of adoption of accounting standards	(168)	—	—	(168)
BALANCE AT OCTOBER 27, 2018	\$ (467)	\$ (14)	\$ (737)	\$ (1,218)
	Net Unrealized Gains (Losses) on Available-for-Sale Investments	Net Unrealized Gains (Losses) on Cash Flow Hedging Instruments	Cumulative Translation Adjustment and Actuarial Gains (Losses)	Accumulated Other Comprehensive Income (Loss)
BALANCE AT JULY 29, 2017	\$ 373	\$ 32	\$ (359)	\$ 46
Other comprehensive income (loss) before reclassifications attributable to Cisco Systems, Inc.	18	8	18	44
(Gains) losses reclassified out of AOCI	(33)	(13)	1	(45)
Tax benefit (expense)	(13)	1	(2)	(14)
Total change for the period	(28)	(4)	17	(15)
BALANCE AT OCTOBER 28, 2017	\$ 345	\$ 28	\$ (342)	\$ 31

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Comprehensive Income Components	Three Months Ended		Line Item in Statements of Operations
	October 2018	October 2017	
	Income Before Taxes		
Net unrealized gains and losses on available-for-sale investments	\$ (6)	\$ 33	Other income (loss), net
Net unrealized gains and losses on cash flow hedging instruments			
Foreign currency derivatives	(1)	10	Operating expenses
Foreign currency derivatives	1	—	Revenue—service
Foreign currency derivatives	—	3	Cost of sales—service
	—	13	
Cumulative translation adjustment and actuarial gains and losses	—	(1)	Operating expenses
Cumulative translation adjustment and actuarial gains and losses	1	—	Other income (loss), net
Total amounts reclassified out of AOCI	\$ (5)	\$ 45	

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

17. Income Taxes

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

	Three Months Ended	
	October 27, 2018	October 28, 2017
Income before provision for income taxes	\$3,909	\$ 2,962
Provision for income taxes	\$360	\$ 568
Effective tax rate	9.2 %	19.2 %

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

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act significantly revises the U.S. corporate income tax by, among other things, lowering the statutory corporate income tax rate ("federal tax rate") from 35% to 21% effective January 1, 2018, implementing a modified territorial tax system, and imposing a mandatory one-time transition tax on accumulated earnings of foreign subsidiaries. The enactment of the Tax Act resulted in us recording a provisional tax expense of \$10.4 billion in fiscal 2018.

In December 2017, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118, which addresses how a company recognizes provisional estimates when a company does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the effect of the changes in the Tax Act. The measurement period ends when a company has obtained, prepared, and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. The final impact of the Tax Act may differ from the above provisional estimates due to changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, by changes in accounting standard for income taxes and related interpretations in response to the Tax Act, and any updates or changes to estimates used in the provisional amounts. We have determined that the \$8.1 billion of tax expense for the U.S. transition tax on accumulated earnings of foreign subsidiaries, the \$1.2 billion of foreign withholding tax, and the \$1.1 billion of tax expense for DTA re-measurement were each provisional amounts and reasonable estimates as of October 27, 2018. Estimates used in the provisional amounts include: the anticipated reversal pattern of the gross DTAs; and earnings, cash positions, foreign taxes and withholding taxes attributable to foreign subsidiaries. The provisional tax expense related to the U.S. transition tax on accumulated earnings in foreign subsidiaries includes an \$863 million benefit related to the U.S. taxation of deemed foreign dividends in the transition fiscal year. This benefit may be reduced or eliminated in future legislation. If such legislation is enacted, we will record the impact of the legislation in the quarter of enactment. The Tax Act includes a Global Intangible Low-Taxed Income ("GILTI") provision that imposes U.S. tax on certain foreign subsidiary income in the year it is earned. Our accounting policy is to treat tax on GILTI as a current period cost included in tax expense in the year incurred.

As of October 27, 2018, we had \$1.9 billion of unrecognized tax benefit, of which \$1.7 billion, if recognized, would favorably impact the effective tax rate. We regularly engage in discussions and negotiations with tax authorities regarding tax matters in various jurisdictions. We believe it is reasonably possible that certain federal, foreign and state tax matters may be concluded in the next 12 months. Specific positions that may be resolved include issues involving transfer pricing and various other matters. We estimate that the unrecognized tax benefits at October 27, 2018 could be reduced by approximately \$200 million in the next 12 months.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

18. Segment Information and Major Customers

(a) Revenue and Gross Margin by Segment

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

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

	Three Months Ended	
	October 2018	October 28, 2017
Revenue:		
Americas	\$7,751	\$ 7,350
EMEA	3,224	2,909
APJC	2,096	1,877
Total	\$13,072	\$ 12,136
Gross margin:		
Americas	\$5,070	\$ 4,722
EMEA	2,070	1,839
APJC	1,200	1,165
Segment total	8,341	7,726
Unallocated corporate items (195) (299)		
Total	\$8,146	\$ 7,427

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

Revenue in the United States was \$6.9 billion and \$6.5 billion for the first quarter of fiscal 2019 and fiscal 2018, respectively.

(b) Revenue for Groups of Similar Products and Services

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

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

	Three Months Ended	
	October 2018	October 28, 2017
Revenue:		
Infrastructure Platforms	\$7,642	\$ 6,980
Applications	1,419	1,203
Security	651	585
Other Products	178	286

Total Product	9,890	9,054
Services	3,182	3,082
Total	\$13,072	\$ 12,136

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(c) Additional Segment Information

The majority of our assets was attributable to our U.S. operations as of each of October 27, 2018 and July 28, 2018.

Property and equipment information is based on the physical location of the assets. The following table presents

property and equipment information for geographic areas (in millions):

	October 27, 2018	July 28, 2018
Property and equipment, net:		
United States	\$ 2,421	\$ 2,487
International	535	519
Total	\$ 2,956	\$ 3,006

19. 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	
	October 27, 2018	October 28, 2017
Net income	\$3,549	\$ 2,394
Weighted-average shares—basic	4,565	4,959
Effect of dilutive potential common shares	49	35
Weighted-average shares—diluted	4,614	4,994
Net income per share—basic	\$0.78	\$ 0.48
Net income per share—diluted	\$0.77	\$ 0.48
Antidilutive employee share-based awards, excluded	9	15

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

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

Forward-Looking Statements

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

OVERVIEW

Cisco designs and sells a broad range of technologies that have been powering the Internet since 1984. Across networking, security, collaboration, applications and the cloud, our evolving intent-based technologies are constantly learning and adapting to provide customers with a highly secure, intelligent platform for their digital business.

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

	Three Months Ended		Variance	
	October 27, 2018	October 28, 2017		
Revenue	\$13,072	\$12,136	8	%
Gross margin percentage	62.3	% 61.2	1.1	pts
Research and development	\$1,608	\$1,567	3	%
Sales and marketing	\$2,410	\$2,334	3	%
General and administrative	\$211	\$557	(62)	%
Total research and development, sales and marketing, general and administrative	\$4,229	\$4,458	(5)	%
Total as a percentage of revenue	32.4	% 36.7	(4.3)	pts
Amortization of purchased intangible assets included in operating expenses	\$34	\$61	(44)	%
Restructuring and other charges included in operating expenses	\$78	\$152	(49)	%
Operating income as a percentage of revenue	29.1	% 22.7	6.4	pts
Income tax percentage	9.2	% 19.2	(10.0)	pts
Net income	\$3,549	\$2,394	48	%
Net income as a percentage of revenue	27.1	% 19.7	7.4	pts
Earnings per share—diluted	\$0.77	\$0.48	60	%

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

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CISCO SYSTEMS, INC.

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

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

Total revenue increased by 8% compared with the first quarter of fiscal 2018. Within total revenue, product revenue increased by 9% and service revenue increased by 3%. Total gross margin increased by 1.1 percentage points, driven primarily by productivity improvements and the \$122 million legal and indemnification settlement charge recorded in the first quarter of fiscal 2018, partially offset by unfavorable impacts from pricing. As a percentage of revenue, research and development, sales and marketing, and general and administrative expenses, collectively, decreased by 4.3 percentage points primarily due to lower general and administrative expenses. General and administrative expenses decreased due to a benefit from the \$400 million litigation settlement with Arista. Operating income as a percentage of revenue increased by 6.4 percentage points. The effective tax rate decreased 10.0 percentage points. Diluted earnings per share increased by 60%, driven by a 48% increase in net income and a decrease in diluted share count of 380 million shares.

In terms of our geographic segments, revenue from the Americas increased \$401 million, EMEA revenue increased by \$315 million, and revenue in our APJC segment increased by \$219 million. These increases reflect broad strength across several countries within these segments. The "BRICM" countries experienced product revenue growth of 24% in the aggregate, driven by increased product revenue in the emerging countries of Mexico, India, Russia and Brazil of 64%, 55%, 23% and 1%, respectively, while product revenue in China was flat.

From a customer market standpoint, we experienced solid product revenue growth in the enterprise and service provider markets and, to a lesser extent, in the public sector and commercial markets.

From a product category perspective, we saw broad-based growth across the portfolio. The product revenue increase of 9% was driven by a 9% product revenue increase in Infrastructure Platforms and solid product revenue growth in Applications and Security, which grew by 18% and 11% respectively.

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CISCO SYSTEMS, INC.

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

Strategy and Priorities

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

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

Other Key Financial Measures

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

	October 27, July 28, 2018 2018	
Cash and cash equivalents and investments	\$ 42,593	\$46,548
Deferred revenue	\$ 16,814	\$19,685
Inventories	\$ 1,572	\$1,846
	Three Months Ended October 27, October 28, 2018 2017	
Cash provided by operating activities	\$3,763	\$ 3,080
Repurchases of common stock—stock repurchase program	\$5,026	\$ 1,620
Dividends	\$1,500	\$ 1,436

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CISCO SYSTEMS, INC.

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

CRITICAL ACCOUNTING ESTIMATES

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

Revenue Recognition

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

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

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

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

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

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

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

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

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

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CISCO SYSTEMS, INC.

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

Allowances for Receivables and Sales Returns

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

	October 27, 2018		July 28, 2018	
Allowance for doubtful accounts	\$	130	\$	129
Percentage of gross accounts receivable	2.8	%	2.3	%
Allowance for credit loss—lease receivables	\$	131	\$	135
Percentage of gross lease receivables ⁽¹⁾	4.9	%	4.7	%
Allowance for credit loss—loan receivables	\$	60	\$	60
Percentage of gross loan receivables	1.2	%	1.2	%

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

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

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

A reserve for future sales returns is established based on historical trends in product return rates. The reserve for future sales returns as of October 27, 2018 and July 28, 2018 was \$112 million and \$123 million, respectively, and was recorded as a reduction of our accounts receivable and revenue. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

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

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

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

Our provision for inventory was \$6 million and \$15 million for the first quarter of fiscal 2019 and 2018, respectively. The provision for the liability related to purchase commitments with contract manufacturers and suppliers was \$18 million and \$21 million for the first quarter of fiscal 2019 and 2018, respectively. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to increase our inventory write-downs, and our liability for purchase commitments with contract manufacturers and suppliers, and accordingly our profitability, could be adversely affected. We regularly evaluate our exposure for inventory write-downs and the adequacy of our liability for purchase commitments.

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CISCO SYSTEMS, INC.

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

Loss Contingencies and Product Warranties

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

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

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

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

Impairment of Investments

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

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

We hold non-marketable equity and other investments, some of which are in the startup or development stages. As of October 27, 2018, our non-marketable equity and other investments were \$1.2 billion, compared with \$1.1 billion as of July 28, 2018, and were included in other assets. We monitor these investments for events or circumstances indicative of potential impairment, and we make appropriate reductions in carrying values if we determine that an impairment charge is required, based primarily on the financial condition and near-term prospects of these companies. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize.

Goodwill and Purchased Intangible Asset Impairments

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

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CISCO SYSTEMS, INC.

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

The goodwill recorded in the Consolidated Balance Sheets as of October 27, 2018 and July 28, 2018 was \$33.4 billion and \$31.7 billion, respectively. In response to changes in industry and market conditions, we could be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill. There was no impairment of goodwill in each of the first quarters of fiscal 2019 and 2018.

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

We make judgments about the recoverability of purchased intangible assets with finite lives whenever events or changes in circumstances indicate that an impairment may exist. Recoverability of purchased intangible assets with finite lives is measured by comparing the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. We review indefinite-lived intangible assets for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. Assumptions and estimates about future values and remaining useful lives of our purchased intangible assets are complex and subjective. They can be affected by a variety of factors, including external factors such as industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts.

There were no impairment charges related to purchased intangible assets for the first quarter of fiscal 2019 and 2018. Our ongoing consideration of all the factors described previously could result in additional impairment charges in the future, which could adversely affect our net income.

Income Taxes

We are subject to income taxes in the United States and numerous foreign jurisdictions. Our effective tax rates differ from the statutory rate, primarily due to the tax impact of state taxes, foreign operations, R&D tax credits, domestic manufacturing deductions, foreign-derived intangible income deductions, global intangible low-taxed income, tax audit settlements, nondeductible compensation, international realignments, and transfer pricing adjustments. Our effective tax rate was 9.2% and 19.2% in the first quarter of fiscal 2019 and 2018, respectively.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted. The Tax Act significantly revises the U.S. corporate income tax by, among other things, lowering the statutory corporate income tax rate ("federal tax rate") from 35% to 21% effective January 1, 2018, implementing a modified territorial tax system, and imposing a mandatory one-time transition tax on accumulated earnings of foreign subsidiaries. As a result of the Tax Act enactment, we recorded a provisional tax expense of \$10.4 billion in fiscal 2018.

In December 2017, the Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118, which addresses how a company recognizes provisional estimates when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the effect of the changes in the Tax Act. The measurement period ends when a company has obtained, prepared, and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. The final impact of the Tax Act may differ from the provisional estimates due to changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, by changes in accounting standard for income taxes and related interpretations in response to the Tax Act, and any updates or changes to estimates used in the provisional amounts. We have determined that the \$8.1 billion of tax expense for the U.S. transition tax on accumulated earnings of foreign subsidiaries, the \$1.2 billion of foreign withholding tax, and the \$1.1 billion of tax expense for DTA re-measurement were each provisional amounts and reasonable estimates as of October 27, 2018. Estimates used in the provisional

amounts include: the anticipated reversal pattern of the gross DTAs; and earnings, cash positions, foreign taxes and withholding taxes attributable to foreign subsidiaries. The provisional tax expense related to the U.S. transition tax on accumulated earnings in foreign subsidiaries includes an \$863 million benefit related to the U.S. taxation of deemed foreign dividends in the transition fiscal year. This benefit may be reduced or eliminated in future legislation. If such legislation is enacted, we will record the impact of the legislation in the quarter of enactment.

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

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

RESULTS OF OPERATIONS

Revenue

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

	Three Months Ended		Variance in Dollars	Variance in Percent
	October 27, 2018	October 28, 2017		
Revenue:				
Product	\$9,890	\$9,054	\$ 836	9 %
Percentage of revenue	75.7 %	74.6 %		
Service	3,182	3,082	100	3 %
Percentage of revenue	24.3 %	25.4 %		
Total	\$13,072	\$12,136	\$ 936	8 %

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

	Three Months Ended		Variance in Dollars	Variance in Percent
	October 27, 2018	October 28, 2017		
Revenue:				
Americas	\$7,751	\$7,350	\$ 401	5 %
Percentage of revenue	59.3 %	60.5 %		
EMEA	3,224	2,909	315	11 %
Percentage of revenue	24.7 %	24.0 %		
APJC	2,096	1,877	219	12 %
Percentage of revenue	16.0 %	15.5 %		
Total	\$13,072	\$12,136	\$ 936	8 %

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Total revenue increased by 8%. Product revenue increased by 9% and service revenue increased by 3%. Our total revenue reflected growth across each of our geographic segments. Product revenue for the emerging countries of BRICM, in the aggregate, experienced 24% product revenue growth, with increases in Mexico, India, Russia and Brazil and product revenue in China being flat.

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

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

Product Revenue by Segment

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

	Three Months Ended				
	October 27, 2018	October 28, 2017	Variance in Dollars	Variance in Percent	
Product revenue:					
Americas	\$5,712	\$ 5,392	\$ 320	6	%
Percentage of product revenue	57.8	% 59.6	%		
EMEA	2,527	2,239	288	13	%
Percentage of product revenue	25.5	% 24.7	%		
APJC	1,652	1,423	229	16	%
Percentage of product revenue	16.7	% 15.7	%		
Total	\$9,890	\$ 9,054	\$ 836	9	%

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Americas

Product revenue in the Americas segment increased by 6%, led by solid growth in the enterprise market and, to a lesser extent, in the commercial, service provider and public sector markets. From a country perspective, product revenue increased by 7% in United States, 22% in Canada, 64% in Mexico and 1% in Brazil.

EMEA

Product revenue in the EMEA segment increased by 13%, with solid growth in the enterprise, service provider and public sector markets. Product revenue in the commercial market in this geographic segment was flat. Product revenue from emerging countries within EMEA increased by 9% and product revenue for the remainder of the EMEA segment, which primarily consists of countries in Western Europe, increased by 14%.

APJC

Product revenue in the APJC segment increased by 16%, with solid growth across each of the customer markets in this geographic segment. From a country perspective, product revenue increased by 55% in India and 8% in Japan while product revenue in China was flat.

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

Product Revenue by Groups of Similar Products

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

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

	Three Months Ended		Variance in Dollars	Variance in Percent	
	October 27, 2018	October 28, 2017			
Product revenue:					
Infrastructure Platforms	\$ 7,642	\$ 6,980	\$ 662	9	%
Applications	1,419	1,203	216	18	%
Security	651	585	66	11	%
Other Products	178	286	(108)	(38)	%
Total	\$ 9,890	\$ 9,054	\$ 836	9	%

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Infrastructure Platforms

The Infrastructure Platforms product category represents our core networking offerings related to switching, routing, wireless, and the data center. Infrastructure Platforms revenue increased by 9%, or \$662 million, with strength across the portfolio. Switching had solid growth, with solid revenue growth in campus switching driven by an increase in sales of our intent-based networking Catalyst 9000 Series, and with revenue growth in data center switching driven by increased revenue from our Nexus 9000 Series. Routing returned to growth driven by growth in the service provider market. We experienced double digit revenue growth from wireless products driven by our Wave 2 offerings as well as Meraki. Our revenue from data center increased driven by higher sales of server products and our hyperconverged data center offering, HyperFlex.

Applications

The Applications product category includes our collaboration offerings (unified communications, Cisco TelePresence and conferencing) as well as the Internet of Things (IoT) and analytics software offerings from Jasper and AppDynamics, respectively. Revenue in our Applications product category increased by 18%, or \$216 million, with growth across all of the business. We had solid revenue growth in unified communications, Telepresence and analytics from AppDynamics.

Security

Revenue in our Security product category increased 11%, or \$66 million, driven by higher sales of identity and access, advance threat security and unified threat management products.

Other Products

The decrease in revenue from our Other Products category was primarily driven by a decrease in revenue from Service Provider Video Software Solutions ("SPVSS"). On May 1, 2018, we announced a definitive agreement to sell the SPVSS business. We closed the sale on October 28, 2018.

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

Service Revenue by Segment

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

	Three Months Ended		Variance in Dollars	Variance in Percent
	October 27, 2018	October 28, 2017		
Service revenue:				
Americas	\$2,040	\$ 1,958	\$ 82	4 %
Percentage of service revenue	64.1 %	63.5 %		
EMEA	697	670	27	4 %
Percentage of service revenue	21.9 %	21.8 %		
APJC	445	454	(9)	(2)%
Percentage of service revenue	14.0 %	14.7 %		
Total	\$3,182	\$ 3,082	\$ 100	3 %

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Service revenue increased 3%, driven by an increase in software and solution support offerings. Service revenue increased in the Americas and EMEA segments, partially offset by decreased revenue in our APJC segment.

Gross Margin

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

	Three Months Ended			
	AMOUNT		PERCENTAGE	
	October 27, 2018	October 28, 2017	October 27, 2018	October 28, 2017
Gross margin:				
Product	\$6,091	\$ 5,439	61.6 %	60.1 %
Service	2,055	1,988	64.6 %	64.5 %
Total	\$8,146	\$ 7,427	62.3 %	61.2 %

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

Product Gross Margin

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

	Product Gross Margin Percentage	
Fiscal 2018	60.1	%
Product pricing	(1.9))%
Mix of products sold	0.3	%
Productivity ⁽¹⁾	1.7	%
Legal and indemnification settlements	1.4	%
Amortization of purchased intangible assets	0.2	%
Other	(0.2))%
Fiscal 2019	61.6	%

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Product gross margin increased by 1.5 percentage points driven by productivity improvements and favorable product mix, partially offset by unfavorable impacts from product pricing. A charge of \$122 million to product cost of sales recorded in the first quarter of fiscal 2018 related to legal and indemnification settlements also contributed to the increase.

Productivity improvements were driven by cost reductions including value engineering efforts (e.g. component redesign, board configuration, test processes, and transformation processes) and continued operational efficiency in manufacturing operations. The increase in product gross margin was also due to a favorable mix of products sold, driven by favorability from the decrease in revenue from SPVSS products. The negative pricing impact, which was lower than the year-over-year impact we experienced in the first quarter of fiscal 2018, was driven by typical market factors and impacted each of our geographic segments and customer markets.

Service Gross Margin

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Our service gross margin percentage increased by 0.1 percentage points due to higher sales volume, partially offset by unfavorable mix and, to a lesser extent, increased headcount-related costs. The mix impacts were due to our lower gross margin advanced services offerings contributing a higher proportion of service revenue for the first quarter of fiscal 2019 compared to the first quarter of fiscal 2018.

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

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Gross Margin by Segment

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

	Three Months Ended			
	AMOUNT		PERCENTAGE	
	October 27, 2018	October 28, 2017	October 27, 2018	October 28, 2017
Gross margin:				
Americas	\$5,070	\$ 4,722	65.4 %	64.2 %
EMEA	2,070	1,839	64.2 %	63.2 %
APJC	1,200	1,165	57.2 %	62.1 %
Segment total	8,341	7,726	63.8 %	63.7 %
Unallocated corporate items ⁽¹⁾	(195)	(299)		
Total	\$8,146	\$ 7,427	62.3 %	61.2 %

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

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

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

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

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

The APJC segment gross margin percentage decreased due primarily to negative impacts from pricing and mix.

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

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

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

	Three Months Ended				Variance in Dollars	Variance in Percent
	October 27, 2018	October 28, 2017				
Research and development	\$ 1,608	\$ 1,567		\$ 41	3 %	
Percentage of revenue	12.3 %	12.9 %				
Sales and marketing	2,410	2,334		76	3 %	
Percentage of revenue	18.4 %	19.2 %				
General and administrative	211	557		(346)	(62)%	
Percentage of revenue	1.6 %	4.6 %				
Total	\$ 4,229	\$ 4,458		\$ (229)	(5)%	
Percentage of revenue	32.4 %	36.7 %				

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

R&D Expenses

R&D expenses increased primarily due to increases in headcount-related expenses, discretionary spending and contracted services.

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

Sales and Marketing Expenses

Sales and marketing expenses increased due to higher discretionary spending, higher headcount-related expenses and, to a lesser extent, higher acquisition-related costs.

G&A Expenses

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

Effect of Foreign Currency

In the first quarter of fiscal 2019, foreign currency fluctuations, net of hedging, decreased the combined R&D, sales and marketing, and G&A expenses by approximately \$50 million, or 1.1%, compared with the first quarter of fiscal 2018.

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Share-Based Compensation Expense

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

	Three Months Ended October 27, 2018		October 28, 2017
Cost of sales—product	\$23	\$	23
Cost of sales—service	33	34	
Share-based compensation expense in cost of sales	56	57	
Research and development	130	136	
Sales and marketing	137	135	
General and administrative	62	64	
Restructuring and other charges	23	6	
Share-based compensation expense in operating expenses	352	341	
Total share-based compensation expense	\$408	\$	398

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

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

Amortization of Purchased Intangible Assets

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

	Three Months Ended October 27, 2018		October 28, 2017
Amortization of purchased intangible assets:			
Cost of sales	\$151	\$	154
Operating expenses	34	61	
Total	\$185	\$	215

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Amortization of purchased intangible assets decreased due to SPVSS purchased intangibles which were held for sale, partially offset by amortization from our recent acquisitions.

Restructuring and Other Charges

We initiated a restructuring plan during fiscal 2018 in order to realign our organization and enable further investment in key priority areas, with estimated pretax charges of approximately \$300 million. In the first quarter of fiscal 2019, we expanded the restructuring plan to include an additional \$300 million of estimated additional pretax charges. In connection with this restructuring plan, we incurred charges of \$78 million during the first quarter of fiscal 2019 and have incurred cumulative charges of \$186 million since inception. We expect this restructuring plan to be substantially completed in fiscal 2019.

We incurred restructuring and other charges of \$152 million during the first quarter of fiscal 2018 in connection with the restructuring plan announced in August 2016.

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

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

Operating Income

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

	Three Months Ended	
	October 27,	October 28,
	2018	2017
Operating income	\$3,805	\$ 2,756
Operating income as a percentage of revenue	29.1 %	22.7 %

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

Operating income increased by 38% and as a percentage of revenue operating income increased by 6.4 percentage points. These increases resulted primarily from: a revenue increase, a gross margin percentage increase (driven primarily by productivity improvements and a charge of \$122 million to product cost of sales recorded in the first quarter of fiscal 2018 related to legal and indemnification settlements), a benefit from the \$400 million litigation settlement with Arista and lower restructuring and other charges.

Interest and Other Income (Loss), Net

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

	Three Months Ended		
	October 27,	October 28,	Variance
	2018	2017	in
			Dollars
Interest income	\$344	\$ 379	\$ (35)
Interest expense	(221)	(235)	14
Interest income (expense), net	\$123	\$ 144	\$ (21)

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

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

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

	Three Months Ended		
	October 27,	October 28,	Variance
	2018	2017	in
			Dollars
Gains (losses) on investments, net:			
Available-for-sale debt investments	\$(6)	\$ 4	\$ (10)
Marketable equity investments	(4)	29	(33)
Non-marketable equity and other investments	4	35	(31)
Net gains (losses) on investments	(6)	68	(74)
Other gains (losses), net	(13)	(6)	(7)
Other income (loss), net	\$(19)	\$ 62	\$ (81)

Three Months Ended October 27, 2018 Compared with Three Months Ended October 28, 2017

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

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

The change in other gains (losses), net was primarily driven by lower gains from customer lease terminations.

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Provision for Income Taxes

The provision for income taxes resulted in an effective tax rate of 9.2% for the first quarter of fiscal 2019 compared with 19.2% for the first quarter of fiscal 2018, a net 10.0 percentage point decrease for the first quarter of fiscal 2019 as compared with the first quarter of fiscal 2018. The decrease in the effective tax rate was primarily due to a decrease of the U.S. federal tax rate from 35% in the first quarter of fiscal 2018 to 21% in the first quarter of fiscal 2019 as the result of enactment of Tax Act and the recognition of a \$152 million tax benefit relating to indirect effects from the adoption of ASC 606 at the beginning of our first quarter of fiscal 2019.

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

LIQUIDITY AND CAPITAL RESOURCES

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

Balance Sheet and Cash Flows

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

	October 27, 2018	July 28, 2018	Increase (Decrease)
Cash and cash equivalents	\$ 8,410	\$8,934	\$ (524)
Available-for-sale debt investments	34,183	37,009	(2,826)
Marketable equity securities	—	605	(605)
Total	\$ 42,593	\$46,548	\$ (3,955)

The decrease in cash and cash equivalents and investments in the first quarter of fiscal 2019 was primarily driven by cash returned to shareholders in the form of repurchases of common stock of \$5.1 billion under the stock repurchase program and cash dividends of \$1.5 billion; net cash paid for acquisitions of \$2.0 billion; and capital expenditures of \$0.2 billion. These uses of cash were partially offset by cash provided by operating activities of \$3.8 billion and timing of settlements of investments and other of \$1.4 billion.

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

Free Cash Flow and Capital Allocation As part of our capital allocation strategy, we intend to return a minimum of 50% of our free cash flow annually to our shareholders through cash dividends and repurchases of common stock.

We define free cash flow as net cash provided by operating activities less cash used to acquire property and equipment. The following table reconciles our net cash provided by operating activities to free cash flow (in millions):

	Three Months Ended	
	October 27, 2018	October 28, 2017
Net cash provided by operating activities	\$3,763	\$ 3,080
Acquisition of property and equipment	(212)	(168)

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

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

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

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

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

Any future dividends are subject to the approval of our Board of Directors.

On February 14, 2018, our Board of Directors authorized a \$25 billion increase to the stock repurchase program. The remaining authorized amount for stock repurchases under this program, including the additional authorization, is approximately \$14.0 billion, with no termination date. We expect to utilize this remaining authorized amount for stock repurchases over the next 9 to 15 months.

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

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

	October 27, 2018	July 28, 2018	Increase (Decrease)
Accounts receivable, net	\$ 4,536	\$ 5,554	\$ (1,018)

Our accounts receivable net, as of October 27, 2018 decreased by approximately 18%, as compared with the end of fiscal 2018, primarily due to the amount and timing of service billings, and also due to product billings being more

linear in the first quarter of fiscal 2019 compared with the fourth quarter of fiscal 2018.

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CISCO SYSTEMS, INC.

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

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

	October 27, 2018	July 28, 2018	Increase (Decrease)
Inventories	\$ 1,572	\$ 1,846	\$ (274)

Inventory as of October 27, 2018 decreased by 15% from our inventory balance at the end of fiscal 2018. The decrease in inventory was due primarily to lower deferred cost of sales related to the adoption of ASC 606 in the beginning of our first quarter of fiscal 2019.

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

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

Commitments by Period	October 27, 2018	July 28, 2018
Less than 1 year	\$ 5,500	\$ 5,407
1 to 3 years	704	710
3 to 5 years	270	360
Total	\$ 6,474	\$ 6,477

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

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

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

	October 27, 2018	July 28, 2018	Increase (Decrease)
Lease receivables, net	\$ 2,399	\$ 2,576	\$ (177)
Loan receivables, net	4,864	4,939	(75)
Financed service contracts, net	2,232	2,316	(84)
Total, net	\$ 9,495	\$ 9,831	\$ (336)

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

long-term service contracts, which primarily relate to technical support services. The majority of the revenue from these financed service contracts is deferred and is recognized ratably over the period during which the services are performed. Financing receivables decreased by 3%. We expect to continue to expand the use of our financing programs in the near term.

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CISCO SYSTEMS, INC.

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

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

The volume of channel partner financing was \$7.2 billion and \$6.7 billion for the first quarter of fiscal 2019 and 2018, respectively. These financing arrangements facilitate the working capital requirements of the channel partners, and in some cases, we guarantee a portion of these arrangements. The balance of the channel partner financing subject to guarantees was \$931 million and \$953 million as of October 27, 2018 and July 28, 2018, respectively. We could be called upon to make payments under these guarantees in the event of nonpayment by the channel partners or end-user customers. Historically, our payments under these arrangements have been immaterial. Where we provide a guarantee, we defer the revenue associated with the channel partner and end-user financing arrangement in accordance with revenue recognition policies, or we record a liability for the fair value of the guarantees. In either case, the deferred revenue is recognized as revenue when the guarantee is removed. As of October 27, 2018, the total maximum potential future payments related to these guarantees was approximately \$335 million, of which approximately \$98 million was recorded as deferred revenue.

Borrowings

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

	Maturity Date	October 27, 2018	July 28, 2018
Senior notes:			
Floating-rate notes:			
Three-month LIBOR plus 0.50%	March 1, 2019	\$ 500	\$ 500
Three-month LIBOR plus 0.34%	September 20, 2019	500	500
Fixed-rate notes:			
4.95%	February 15, 2019	2,000	2,000
1.60%	February 28, 2019	1,000	1,000
2.125%	March 1, 2019	1,750	1,750
1.40%	September 20, 2019	1,500	1,500
4.45%	January 15, 2020	2,500	2,500
2.45%	June 15, 2020	1,500	1,500
2.20%	February 28, 2021	2,500	2,500
2.90%	March 4, 2021	500	500
1.85%	September 20, 2021	2,000	2,000
3.00%	June 15, 2022	500	500
2.60%		500	500

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	February 28, 2023		
2.20%	September 20, 2023	750	750
3.625%	March 4, 2024	1,000	1,000
3.50%	June 15, 2025	500	500
2.95%	February 28, 2026	750	750
2.50%	September 20, 2026	1,500	1,500
5.90%	February 15, 2039	2,000	2,000
5.50%	January 15, 2040	2,000	2,000
Total		\$ 25,750	\$ 25,750

Interest is payable semiannually on each class of the senior fixed-rate notes, each of which is redeemable by us at any time, subject to a make-whole premium. Interest is payable quarterly on the floating-rate notes. We were in compliance with all debt covenants as of October 27, 2018.

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CISCO SYSTEMS, INC.

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

Commercial Paper We have a short-term debt financing program in which up to \$10.0 billion is available through the issuance of commercial paper notes. We use the proceeds from the issuance of commercial paper notes for general corporate purposes. We had no commercial paper notes outstanding as of October 27, 2018 and July 28, 2018.

Credit Facility On May 15, 2015, we entered into a credit agreement with certain institutional lenders that provides for a \$3.0 billion unsecured revolving credit facility that is scheduled to expire on May 15, 2020. Any advances under the credit agreement will accrue interest at rates that are equal to, based on certain conditions, either (i) the highest of (a) the Federal Funds rate plus 0.50%, (b) Bank of America's "prime rate" as announced from time to time, or (c) LIBOR, or a comparable or successor rate that is approved by the Administrative Agent ("Eurocurrency Rate"), for an interest period of one month plus 1.00%, or (ii) the Eurocurrency Rate, plus a margin that is based on our senior debt credit ratings as published by Standard & Poor's Financial Services, LLC and Moody's Investors Service, Inc., provided that in no event will the Eurocurrency Rate be less than zero. We may also, upon the agreement of either the then-existing lenders or additional lenders not currently parties to the agreement, increase the commitments under the credit facility by up to an additional \$2.0 billion and/or extend the expiration date of the credit facility up to May 15, 2022. This credit agreement requires that we comply with certain covenants, including that we maintain an interest coverage ratio as defined in the agreement. As of October 27, 2018, we were in compliance with the required interest coverage ratio and the other covenants, and we had not borrowed any funds under the credit facility.

Deferred Revenue The following table presents the breakdown of deferred revenue (in millions):

	October 27, 2018	July 28, 2018	Increase (Decrease)
Service	\$ 11,062	\$ 11,431	\$ (369)
Product	5,752	8,254	(2,502)
Total	\$ 16,814	\$ 19,685	\$ (2,871)
Reported as:			
Current	\$ 9,637	\$ 11,490	\$ (1,853)
Noncurrent	7,177	8,195	(1,018)
Total	\$ 16,814	\$ 19,685	\$ (2,871)

Deferred revenue decreased primarily due to the adoption of ASC 606 in the beginning of our first quarter of fiscal 2019. Of the total deferred revenue decrease related to ASC 606 of \$2.8 billion, \$2.6 billion relates to deferred product revenue and \$0.2 billion relates to deferred service revenue. Of the adjustment to deferred product revenue, \$1.3 billion relates to our recurring software and subscription offers, \$0.6 billion relates to two-tier distribution, and the remainder relates to non-recurring software and other adjustments.

Contractual Obligations**Operating Leases**

We lease office space in many U.S. locations. Outside the United States, larger leased sites include sites in Belgium, Canada, China, Germany, India, Israel, Japan, Mexico, Poland and the United Kingdom. We also lease equipment and vehicles. The future minimum lease payments under all of our noncancelable operating leases with an initial term in excess of one year as of October 27, 2018 were \$1.2 billion.

Transition Tax Payable

In connection with the Tax Act, we recorded an income tax payable of \$8.1 billion for the U.S. transition tax on accumulated earnings of foreign subsidiaries. Amounts associated with the Tax Act are considered provisional and may be subject to further adjustment during the measurement period. We plan to pay the transition tax in installments over eight years in accordance with the Tax Act. Approximately \$0.8 billion is payable in less than one year; \$1.3 billion is payable between 1 to 3 years; another \$1.3 billion is payable between 3 to 5 years; and the remaining \$4.7 billion is payable in more than 5 years. See Note 17 to the Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

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

Other Commitments

In connection with our acquisitions, we have agreed to pay certain additional amounts contingent upon the achievement of certain agreed-upon technology, development, product, or other milestones or the continued employment with us of certain employees of the acquired entities. See Note 13 to the Consolidated Financial Statements.

Other Funding Commitments We also have certain funding commitments primarily related to our non-marketable equity and other investments, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The funding commitments were \$378 million as of October 27, 2018, compared with \$223 million as of July 28, 2018.

Off-Balance Sheet Arrangements

We consider our investments in unconsolidated variable interest entities to be off-balance sheet arrangements. In the ordinary course of business, we have non-marketable equity and other investments and provide financing to certain customers. Certain of these investments are considered to be variable interest entities. We evaluate on an ongoing basis our non-marketable equity and other investments and customer financings, and we have determined that as of October 27, 2018 there were no material unconsolidated variable interest entities.

On an ongoing basis, we reassess our non-marketable equity and other investments and customer financings to determine if they are variable interest entities and if we would be regarded as the primary beneficiary pursuant to the applicable accounting guidance. As a result of this ongoing assessment, we may be required to make additional disclosures or consolidate these entities. Because we may not control these entities, we may not have the ability to influence these events.

We provide financing guarantees, which are generally for various third-party financing arrangements extended to our channel partners and end-user customers. We could be called upon to make payments under these guarantees in the event of nonpayment by the channel partners or end-user customers. See the previous discussion of these financing guarantees under "Financing Receivables and Guarantees."

Liquidity and Capital Resource Requirements

Based on past performance and current expectations, we believe our cash and cash equivalents, investments, cash generated from operations, and ability to access capital markets and committed credit lines will satisfy, through at least the next 12 months, our liquidity requirements, both in total and domestically, including the following: working capital needs, capital expenditures, investment requirements, stock repurchases, cash dividends, contractual obligations, commitments, principal and interest payments on debt, pending acquisitions, future customer financings, and other liquidity requirements associated with our operations. There are no other transactions, arrangements, or relationships with unconsolidated entities or other persons that are reasonably likely to materially affect the liquidity and the availability of, as well as our requirements for, capital resources.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our financial position is exposed to a variety of risks, including interest rate risk, equity price risk, and foreign currency exchange risk.

Interest Rate Risk

Available-for-Sale Debt Investments We maintain an investment portfolio of various holdings, types, and maturities. Our primary objective for holding available-for-sale debt investments is to achieve an appropriate investment return consistent with preserving principal and managing risk. At any time, a sharp rise in market interest rates could have a material adverse impact on the fair value of our available-for-sale debt investment portfolio. Conversely, declines in interest rates, including the impact from lower credit spreads, could have a material adverse impact on interest income for our investment portfolio. We may utilize derivative instruments designated as hedging instruments to achieve our investment objectives. We had no outstanding hedging instruments for our available-for-sale debt investments as of

October 27, 2018. Our available-for-sale debt investments are held for purposes other than trading. Our available-for-sale debt investments are not leveraged as of October 27, 2018. We monitor our interest rate and credit risks, including our credit exposures to specific rating categories and to individual issuers. We believe the overall credit quality of our portfolio is strong.

Financing Receivables As of October 27, 2018, our financing receivables had a carrying value of \$9.5 billion, compared with \$9.8 billion as of July 28, 2018. As of October 27, 2018, a hypothetical 50 basis points (“BPS”) increase or decrease in market interest rates would change the fair value of our financing receivables by a decrease or increase of approximately \$0.1 billion, respectively.

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Debt As of October 27, 2018, we had \$25.8 billion in principal amount of senior notes outstanding, which consisted of \$1.0 billion floating-rate notes and \$24.8 billion fixed-rate notes. The carrying amount of the senior notes was \$25.6 billion, and the related fair value based on market prices was \$26.2 billion. As of October 27, 2018, a hypothetical 50 BPS increase or decrease in market interest rates would change the fair value of the fixed-rate debt, excluding the \$6.8 billion of hedged debt, by a decrease or increase of approximately \$0.5 billion, respectively. However, this hypothetical change in interest rates would not impact the interest expense on the fixed-rate debt that is not hedged.

Equity Price Risk

Marketable Equity Investments. The fair value of our marketable equity investments, if any, is subject to market price volatility. We may hold equity securities for strategic purposes or to diversify our overall investment portfolio. Our equity portfolio consists of securities with characteristics that most closely match the Standard & Poor's 500 Index or Nasdaq Composite Index. These equity securities are held for purposes other than trading. To manage our exposure to changes in the fair value of certain equity securities, we may enter into equity derivatives designated as hedging instruments. We had no outstanding marketable equity investments as of October 27, 2018.

Non-marketable Equity and Other Investments These investments are recorded in other assets in our Consolidated Balance Sheets. As of October 27, 2018, the total carrying amount of our investments in non-marketable equity and other investments was \$1.2 billion, compared with \$1.1 billion at July 28, 2018. Some of these companies in which we invested are in the startup or development stages. 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. We could lose our entire investment in these companies. Our evaluation of non-marketable equity and other investments is based on the fundamentals of the businesses invested in, including, among other factors, the nature of their technologies and potential for financial return.

Foreign Currency Exchange Risk

Our foreign exchange forward and option contracts outstanding as of the respective period-ends are summarized in U.S. dollar equivalents as follows (in millions):

	October 27, 2018		July 28, 2018	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Forward contracts:				
Purchased	\$1,735	\$ (4)	\$1,850	\$ (2)
Sold	\$900	\$ 4	\$845	\$ 2
Option contracts:				
Purchased	\$298	\$ 1	\$—	\$ —
Sold	\$279	\$ (6)	\$—	\$ —

We conduct business globally in numerous currencies. The direct effect of foreign currency fluctuations on revenue has not been material because our revenue is 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 revenue 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 revenue is influenced by many factors in addition to the impact of such currency fluctuations.

Approximately 70% of our operating expenses are U.S.-dollar denominated. In the first quarter of fiscal 2019, foreign currency fluctuations, net of hedging, decreased our combined R&D, sales and marketing, and G&A expenses by approximately \$50 million, or 1.1%, compared with the first quarter of fiscal 2018. To reduce variability in operating expenses and service cost of sales caused by non-U.S.-dollar denominated operating expenses and costs, we may hedge certain forecasted foreign currency transactions with currency options and forward contracts. These hedging programs are not designed to provide foreign currency protection over long time horizons. In designing a specific hedging approach, we consider several factors, including offsetting exposures, significance of exposures, costs associated with entering into a particular hedge instrument, and potential effectiveness of the hedge. The gains and losses on foreign exchange contracts mitigate the effect of currency movements on our operating expenses and service

cost of sales.

We also enter into foreign exchange forward and option contracts to reduce the short-term effects of foreign currency fluctuations on receivables and payables that are denominated in currencies other than the functional currencies of the entities. The market risks associated with these foreign currency receivables, investments, and payables relate primarily to variances from our forecasted foreign currency transactions and balances. We do not enter into foreign exchange forward or option contracts for speculative purposes.

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Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our first quarter of fiscal 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. During the first quarter of fiscal 2019, we implemented and modified certain internal controls over financial reporting relating to the adoption and ongoing operation of ASC 606.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a description of our material pending legal proceedings, see Note 13 "Commitments and Contingencies—(g) Legal Proceedings" of the Notes to Consolidated Financial Statements included in Item 1 of this Form 10-Q.

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Item 1A. Risk Factors

Set forth below and elsewhere in this report and in other documents we file with the SEC are descriptions of the risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in “Part I, Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended July 28, 2018.

OUR OPERATING RESULTS MAY FLUCTUATE IN FUTURE PERIODS, WHICH MAY ADVERSELY AFFECT OUR STOCK PRICE

Our operating results have been in the past, and will continue to be, subject to quarterly and annual fluctuations as a result of numerous factors, some of which may contribute to more pronounced fluctuations in an uncertain global economic environment. These factors include:

- Fluctuations in demand for our products and services, especially with respect to service providers and Internet businesses, in part due to changes in the global economic environment
 - Changes in sales and implementation cycles for our products and reduced visibility into our customers’ spending plans and associated revenue
 - Our ability to maintain appropriate inventory levels and purchase commitments
 - Price and product competition in the communications and networking industries, which can change rapidly due to technological innovation and different business models from various geographic regions
 - The overall movement toward industry consolidation among both our competitors and our customers
 - The introduction and market acceptance of new technologies and products, and our success in new and evolving markets, and in emerging technologies, as well as the adoption of new standards
 - The transformation of our business to deliver more software and subscription offerings where revenue is recognized over time
 - Variations in sales channels, product costs, mix of products sold, or mix of direct sales and indirect sales
 - The timing, size, and mix of orders from customers
 - Manufacturing and customer lead times
 - Fluctuations in our gross margins, and the factors that contribute to such fluctuations, as described below
- The ability of our customers, channel partners, contract manufacturers and suppliers to obtain financing or to fund capital expenditures, especially during a period of global credit market disruption or in the event of customer, channel partner, contract manufacturer or supplier financial problems
- Actual events, circumstances, outcomes, and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of related valuation allowances), liabilities, and other items reflected in our Consolidated Financial Statements
- How well we execute on our strategy and operating plans and the impact of changes in our business model that could result in significant restructuring charges
 - Our ability to achieve targeted cost reductions
 - Benefits anticipated from our investments in engineering, sales, service, and marketing
 - Changes in tax laws or accounting rules, or interpretations thereof

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As a consequence, operating results for a particular future period are difficult to predict, and, therefore, prior results are not necessarily indicative of results to be expected in future periods. Any of the foregoing factors, or any other factors discussed elsewhere herein, could have a material adverse effect on our business, results of operations, and financial condition that could adversely affect our stock price.

OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED BY UNFAVORABLE ECONOMIC AND MARKET CONDITIONS AND THE UNCERTAIN GEOPOLITICAL ENVIRONMENT

Challenging economic conditions worldwide have from time to time contributed, and may continue to contribute, to slowdowns in the communications and networking industries at large, as well as in specific segments and markets in which we operate, resulting in:

- Reduced demand for our products as a result of continued constraints on IT-related capital spending by our customers, particularly service providers, and other customer markets as well
- Increased price competition for our products, not only from our competitors but also as a consequence of customers disposing of unutilized products
- Risk of excess and obsolete inventories
- Risk of supply constraints
- Risk of excess facilities and manufacturing capacity
- Higher overhead costs as a percentage of revenue and higher interest expense

The global macroeconomic environment has been challenging and inconsistent. Instability in the global credit markets, the impact of uncertainty regarding global central bank monetary policy, the instability in the geopolitical environment in many parts of the world including as a result of the recent United Kingdom “Brexit” referendum to withdraw from the European Union, the current economic challenges in China, including global economic ramifications of Chinese economic difficulties, and other disruptions may continue to put pressure on global economic conditions. If global economic and market conditions, or economic conditions in key markets, remain uncertain or deteriorate further, we may experience material impacts on our business, operating results, and financial condition. Our operating results in one or more segments may also be affected by uncertain or changing economic conditions particularly germane to that segment or to particular customer markets within that segment. For example, emerging countries in the aggregate experienced a decline in product orders in the first quarter of fiscal 2018, in fiscal 2017 and in certain prior periods.

In addition, reports of certain intelligence gathering methods of the U.S. government could affect customers’ perception of the products of IT companies which design and manufacture products in the United States. Trust and confidence in us as an IT supplier is critical to the development and growth of our markets. Impairment of that trust, or foreign regulatory actions taken in response to reports of certain intelligence gathering methods of the U.S. government, could affect the demand for our products from customers outside of the United States and could have an adverse effect on our operating results.

WE HAVE BEEN INVESTING AND EXPECT TO CONTINUE TO INVEST IN KEY PRIORITY AND GROWTH AREAS AS WELL AS MAINTAINING LEADERSHIP IN INFRASTRUCTURE PLATFORMS AND IN SERVICES, AND IF THE RETURN ON THESE INVESTMENTS IS LOWER OR DEVELOPS MORE SLOWLY THAN WE EXPECT, OUR OPERATING RESULTS MAY BE HARMED

We expect to realign and dedicate resources into key priority and growth areas, such as Security and Applications, while also focusing on maintaining leadership in Infrastructure Platforms and in Services. However, the return on our investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments (including if our selection of areas for investment does not play out as we expect), or if the achievement of these benefits is delayed, our operating results may be adversely affected.

OUR REVENUE FOR A PARTICULAR PERIOD IS DIFFICULT TO PREDICT, AND A SHORTFALL IN REVENUE MAY HARM OUR OPERATING RESULTS

As a result of a variety of factors discussed in this report, our revenue for a particular quarter is difficult to predict, especially in light of a challenging and inconsistent global macroeconomic environment and related market uncertainty.

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Our revenue may grow at a slower rate than in past periods or decline as it did in the first quarter of fiscal 2018 and in fiscal 2017 on a year-over-year basis. Our ability to meet financial expectations could also be adversely affected if the nonlinear sales pattern seen in some of our past quarters recurs in future periods. We have experienced periods of time during which shipments have exceeded net bookings or manufacturing issues have delayed shipments, leading to nonlinearity in shipping patterns. In addition to making it difficult to predict revenue for a particular period, nonlinearity in shipping can increase costs, because irregular shipment patterns result in periods of underutilized capacity and periods in which overtime expenses may be incurred, as well as in potential additional inventory management-related costs. In addition, to the extent that manufacturing issues and any related component shortages result in delayed shipments in the future, and particularly in periods in which our contract manufacturers are operating at higher levels of capacity, it is possible that revenue for a quarter could be adversely affected if such matters occur and are not remediated within the same quarter.

The timing of large orders can also have a significant effect on our business and operating results from quarter to quarter, primarily in the United States and in emerging countries. From time to time, we receive large orders that have a significant effect on our operating results in the period in which the order is recognized as revenue. The timing of such orders is difficult to predict, and the timing of revenue recognition from such orders may affect period to period changes in revenue. As a result, our operating results could vary materially from quarter to quarter based on the receipt of such orders and their ultimate recognition as revenue.

Inventory management remains an area of focus. We have experienced longer than normal manufacturing lead times in the past which have caused some customers to place the same order multiple times within our various sales channels and to cancel the duplicative orders upon receipt of the product, or to place orders with other vendors with shorter manufacturing lead times. Such multiple ordering (along with other factors) or risk of order cancellation may cause difficulty in predicting our revenue and, as a result, could impair our ability to manage parts inventory effectively. In addition, our efforts to improve manufacturing lead-time performance may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter revenue and operating results. In addition, when facing component supply-related challenges we have increased our efforts in procuring components in order to meet customer expectations, which in turn contribute to an increase in purchase commitments. Increases in our purchase commitments to shorten lead times could also lead to excess and obsolete inventory charges if the demand for our products is less than our expectations.

We plan our operating expense levels based primarily on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. A shortfall in revenue could lead to operating results being below expectations because we may not be able to quickly reduce these fixed expenses in response to short-term business changes.

Any of the above factors could have a material adverse impact on our operations and financial results.

WE EXPECT GROSS MARGIN TO VARY OVER TIME, AND OUR LEVEL OF PRODUCT GROSS MARGIN MAY NOT BE SUSTAINABLE

Our product gross margins declined in certain prior periods on a year-over-year basis and could decline in future quarters due to adverse impacts from various factors, including:

- Changes in customer, geographic, or product mix, including mix of configurations within each product group
- Introduction of new products, including products with price-performance advantages, and new business models including the transformation of our business to deliver more software and subscription offerings
- Our ability to reduce production costs
- Entry into new markets or growth in lower margin markets, including markets with different pricing and cost structures, through acquisitions or internal development
- Sales discounts
- Increases in material, labor or other manufacturing-related costs, which could be significant especially during periods of supply constraints such as those impacting the market for memory components
- Excess inventory and inventory holding charges
- Obsolescence charges
- Changes in shipment volume

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- The timing of revenue recognition and revenue deferrals
- Increased cost (including those caused by tariffs), loss of cost savings or dilution of savings due to changes in
- component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand or if the financial health of either contract manufacturers or suppliers deteriorates
- Lower than expected benefits from value engineering
- Increased price competition, including competitors from Asia, especially from China
- Changes in distribution channels
- Increased warranty costs
- Increased amortization of purchased intangible assets, especially from acquisitions
- How well we execute on our strategy and operating plans

Changes in service gross margin may result from various factors such as changes in the mix between technical support services and advanced services, as well as the timing of technical support service contract initiations and renewals and the addition of personnel and other resources to support higher levels of service business in future periods.

SALES TO THE SERVICE PROVIDER MARKET ARE ESPECIALLY VOLATILE, AND WEAKNESS IN ORDERS FROM THIS INDUSTRY MAY HARM OUR OPERATING RESULTS AND FINANCIAL CONDITION

Sales to the service provider market have been characterized by large and sporadic purchases, especially relating to our router sales and sales of certain other Infrastructure Platforms and Applications products, in addition to longer sales cycles. Although product orders from the service provider market increased in the first quarter of fiscal 2019 and fourth quarter of fiscal 2018, service provider product orders decreased in the first nine months of fiscal 2018 and in fiscal 2017, and at various times in the past we have experienced significant weakness in product orders from service providers. Product orders from the service provider market could continue to decline and, as has been the case in the past, such weakness could persist over extended periods of time given fluctuating market conditions. Sales activity in this industry depends upon the stage of completion of expanding network infrastructures; the availability of funding; and the extent to which service providers are affected by regulatory, economic, and business conditions in the country of operations. Weakness in orders from this industry, including as a result of any slowdown in capital expenditures by service providers (which may be more prevalent during a global economic downturn, or periods of economic, political or regulatory uncertainty), could have a material adverse effect on our business, operating results, and financial condition. Such slowdowns may continue or recur in future periods. Orders from this industry could decline for many reasons other than the competitiveness of our products and services within their respective markets. For example, in the past, many of our service provider customers have been materially and adversely affected by slowdowns in the general economy, by overcapacity, by changes in the service provider market, by regulatory developments, and by constraints on capital availability, resulting in business failures and substantial reductions in spending and expansion plans. These conditions have materially harmed our business and operating results in the past, and some of these or other conditions in the service provider market could affect our business and operating results in any future period. Finally, service provider customers typically have longer implementation cycles; require a broader range of services, including design services; demand that vendors take on a larger share of risks; often require acceptance provisions, which can lead to a delay in revenue recognition; and expect financing from vendors. All these factors can add further risk to business conducted with service providers.

DISRUPTION OF OR CHANGES IN OUR DISTRIBUTION MODEL COULD HARM OUR SALES AND MARGINS

If we fail to manage distribution of our products and services properly, or if our distributors' financial condition or operations weaken, our revenue and gross margins could be adversely affected.

A substantial portion of our products and services is sold through our channel partners, and the remainder is sold through direct sales. Our channel partners include systems integrators, service providers, other resellers, and distributors. Systems integrators and service providers typically sell directly to end users and often provide system installation, technical support, professional services, and other support services in addition to network equipment sales. Systems integrators also typically integrate our products into an overall solution, and a number of service providers are also systems integrators. Distributors stock inventory and typically sell to systems integrators, service providers, and other resellers. We refer to sales through distributors as our two-tier system of sales to the end

customer. These distributors are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. If sales through indirect

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channels increase, this may lead to greater difficulty in forecasting the mix of our products and, to a degree, the timing of orders from our customers.

Historically, we have seen fluctuations in our gross margins based on changes in the balance of our distribution channels. Although variability to date has not been significant, there can be no assurance that changes in the balance of our distribution model in future periods would not have an adverse effect on our gross margins and profitability. Some factors could result in disruption of or changes in our distribution model, which could harm our sales and margins, including the following:

- We compete with some of our channel partners, including through our direct sales, which may lead these channel partners to use other suppliers that do not directly sell their own products or otherwise compete with them
- Some of our channel partners may demand that we absorb a greater share of the risks that their customers may ask them to bear
- Some of our channel partners may have insufficient financial resources and may not be able to withstand changes and challenges in business conditions
- Revenue from indirect sales could suffer if our distributors' financial condition or operations weaken

In addition, we depend on our channel partners globally to comply with applicable regulatory requirements. To the extent that they fail to do so, that could have a material adverse effect on our business, operating results, and financial condition. Further, sales of our products outside of agreed territories can result in disruption to our distribution channels.

THE MARKETS IN WHICH WE COMPETE ARE INTENSELY COMPETITIVE, WHICH COULD ADVERSELY AFFECT OUR ACHIEVEMENT OF REVENUE GROWTH

The markets in which we compete are characterized by rapid change, converging technologies, and a migration to networking and communications solutions that offer relative advantages. These market factors represent a competitive threat to us. We compete with numerous vendors in each product category. The overall number of our competitors providing niche product solutions may increase. Also, the identity and composition of competitors may change as we increase our activity in newer product areas, and in key priority and growth areas. For example, as products related to network programmability, such as SDN products, become more prevalent, we expect to face increased competition from companies that develop networking products based on commoditized hardware, referred to as "white box" hardware, to the extent customers decide to purchase those product offerings instead of ours. In addition, the growth in demand for technology delivered as a service enables new competitors to enter the market.

As we continue to expand globally, we may see new competition in different geographic regions. In particular, we have experienced price-focused competition from competitors in Asia, especially from China, and we anticipate this will continue. Our competitors include Amazon Web Services LLC; Arista Networks, Inc.; ARRIS Group, Inc.; Check Point Software Technologies Ltd.; Dell Technologies Inc.; Extreme Networks, Inc.; F5 Networks, Inc.; FireEye, Inc.; Fortinet, Inc.; Hewlett-Packard Enterprise Company; Huawei Technologies Co., Ltd.; Juniper Networks, Inc.; Lenovo Group Limited; Microsoft Corporation; New Relic, Inc.; Nokia Corporation; Nutanix, Inc.; Palo Alto Networks, Inc.; Symantec Corporation; Ubiquiti Networks and VMware, Inc.; among others.

Some of our competitors compete across many of our product lines, while others are primarily focused in a specific product area. Barriers to entry are relatively low, and new ventures to create products that do or could compete with our products are regularly formed. In addition, some of our competitors may have greater resources, including technical and engineering resources, than we do. As we expand into new markets, we will face competition not only from our existing competitors but also from other competitors, including existing companies with strong technological, marketing, and sales positions in those markets. We also sometimes face competition from resellers and distributors of our products. Companies with which we have strategic alliances in some areas may be competitors in other areas, and in our view this trend may increase.

For example, the enterprise data center is undergoing a fundamental transformation arising from the convergence of technologies, including computing, networking, storage, and software, that previously were segregated. Due to several factors, including the availability of highly scalable and general purpose microprocessors, ASICs offering advanced services, standards based protocols, cloud computing and virtualization, the convergence of technologies within the enterprise data center is spanning multiple, previously independent, technology segments. Also, some of our current

and potential competitors for enterprise data center business have made acquisitions, or announced new strategic alliances, designed to position them to provide end-to-end technology solutions for the enterprise data center. As a result of all of these developments, we face greater competition in the development and sale of enterprise data center technologies, including competition from entities that are among our long-term strategic alliance partners. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us.

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The principal competitive factors in the markets in which we presently compete and may compete in the future include:

- The ability to sell successful business outcomes
- The ability to provide a broad range of networking and communications products and services
- Product performance
- Price
- The ability to introduce new products, including providing continuous new customer value and products with price-performance advantages
- The ability to reduce production costs
 - The ability to provide value-added features such as security, reliability, and investment protection
- Conformance to standards
- Market presence
- The ability to provide financing
- Disruptive technology shifts and new business models

We also face competition from customers to which we license or supply technology and suppliers from which we transfer technology. The inherent nature of networking requires interoperability. As such, we must cooperate and at the same time compete with many companies. Any inability to effectively manage these complicated relationships with customers, suppliers, and strategic alliance partners could have a material adverse effect on our business, operating results, and financial condition and accordingly affect our chances of success.

OUR INVENTORY MANAGEMENT RELATING TO OUR SALES TO OUR TWO-TIER DISTRIBUTION CHANNEL IS COMPLEX, AND EXCESS INVENTORY MAY HARM OUR GROSS MARGINS

We must manage our inventory relating to sales to our distributors effectively, because inventory held by them could affect our results of operations. Our distributors may increase orders during periods of product shortages, cancel orders if their inventory is too high, or delay orders in anticipation of new products. They also may adjust their orders in response to the supply of our products and the products of our competitors that are available to them, and in response to seasonal fluctuations in end-user demand. Our distributors are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling price, and participate in various cooperative marketing programs. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology and customer requirements. When facing component supply-related challenges, we have increased our efforts in procuring components in order to meet customer expectations. If we ultimately determine that we have excess inventory, we may have to reduce our prices and write down inventory, which in turn could result in lower gross margins.

SUPPLY CHAIN ISSUES, INCLUDING FINANCIAL PROBLEMS OF CONTRACT MANUFACTURERS OR COMPONENT SUPPLIERS, OR A SHORTAGE OF ADEQUATE COMPONENT SUPPLY OR MANUFACTURING CAPACITY THAT INCREASED OUR COSTS OR CAUSED A DELAY IN OUR ABILITY TO FULFILL ORDERS, COULD HAVE AN ADVERSE IMPACT ON OUR BUSINESS AND OPERATING RESULTS, AND OUR FAILURE TO ESTIMATE CUSTOMER DEMAND PROPERLY MAY RESULT IN EXCESS OR OBSOLETE COMPONENT SUPPLY, WHICH COULD ADVERSELY AFFECT OUR GROSS MARGINS

The fact that we do not own or operate the bulk of our manufacturing facilities and that we are reliant on our extended supply chain could have an adverse impact on the supply of our products and on our business and operating results:

- Any financial problems of either contract manufacturers or component suppliers could either limit supply or increase costs

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- Reservation of manufacturing capacity at our contract manufacturers by other companies, inside or outside of our industry, could either limit supply or increase costs
- Industry consolidation occurring within one or more component supplier markets, such as the semiconductor market, could either limit supply or increase costs

A reduction or interruption in supply; a significant increase in the price of one or more components; a failure to adequately authorize procurement of inventory by our contract manufacturers; a failure to appropriately cancel, reschedule, or adjust our requirements based on our business needs; or a decrease in demand for our products could materially adversely affect our business, operating results, and financial condition and could materially damage customer relationships. Furthermore, as a result of binding price or purchase commitments with suppliers, we may be obligated to purchase components at prices that are higher than those available in the current market. In the event that we become committed to purchase components at prices in excess of the current market price when the components are actually used, our gross margins could decrease. We have experienced longer than normal lead times in the past. Although we have generally secured additional supply or taken other mitigation actions when significant disruptions have occurred, if similar situations occur in the future, they could have a material adverse effect on our business, results of operations, and financial condition. See the risk factor above entitled “Our revenue for a particular period is difficult to predict, and a shortfall in revenue may harm our operating results.”

Our growth and ability to meet customer demands depend in part on our ability to obtain timely deliveries of parts from our suppliers and contract manufacturers. We have experienced component shortages in the past, including shortages caused by manufacturing process issues, that have affected our operations. We may in the future experience a shortage of certain component parts as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers including capacity or cost problems resulting from industry consolidation, or strong demand in the industry for those parts. Growth in the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and component demands within specific product categories and to establish optimal component levels and manufacturing capacity, especially for labor-intensive components, components for which we purchase a substantial portion of the supply, or the re-ramping of manufacturing capacity for highly complex products. During periods of shortages or delays the price of components may increase, or the components may not be available at all, and we may also encounter shortages if we do not accurately anticipate our needs. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner in the quantities or configurations needed. Accordingly, our revenue and gross margins could suffer until other sources can be developed. Our operating results would also be adversely affected if, anticipating greater demand than actually develops, we commit to the purchase of more components than we need, which is more likely to occur in a period of demand uncertainties such as we are currently experiencing. There can be no assurance that we will not encounter these problems in the future. Although in many cases we use standard parts and components for our products, certain components are presently available only from a single source or limited sources, and a global economic downturn and related market uncertainty could negatively impact the availability of components from one or more of these sources, especially during times such as we have recently seen when there are supplier constraints based on labor and other actions taken during economic downturns. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

We believe that we may be faced with the following challenges in the future:

- New markets in which we participate may grow quickly, which may make it difficult to quickly obtain significant component capacity
- As we acquire companies and new technologies, we may be dependent, at least initially, on unfamiliar supply chains or relatively small supply partners
- We face competition for certain components that are supply-constrained, from existing competitors, and companies in other markets

Manufacturing capacity and component supply constraints could continue to be significant issues for us. We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to improve manufacturing lead-time performance and to

help ensure adequate component supply, we enter into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by us or that establish the parameters defining our requirements. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. When facing component supply-related challenges we have increased our efforts in procuring components in order to meet customer expectations, which in turn contributes to an increase in purchase commitments. Increases in our purchase commitments to shorten lead times could also lead to excess and obsolete inventory charges if the demand for our products is less than our expectations.

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If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete components that could adversely affect our gross margins. For additional information regarding our purchase commitments with contract manufacturers and suppliers, see Note 13 to the Consolidated Financial Statements. **WE DEPEND UPON THE DEVELOPMENT OF NEW PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCTS, AND IF WE FAIL TO PREDICT AND RESPOND TO EMERGING TECHNOLOGICAL TRENDS AND CUSTOMERS' CHANGING NEEDS, OUR OPERATING RESULTS AND MARKET SHARE MAY SUFFER**

The markets for our products are characterized by rapidly changing technology, evolving industry standards, new product introductions, and evolving methods of building and operating networks. Our operating results depend on our ability to develop and introduce new products into existing and emerging markets and to reduce the production costs of existing products. Many of our strategic initiatives and investments we have made, and our architectural approach, are designed to enable the increased use of the network as the platform for automating, orchestrating, integrating, and delivering an ever-increasing array of IT-based products and services. For example, in June 2017 we announced our Catalyst 9000 series of switches which represent the initial foundation of our intent-based networking capabilities. Other current initiatives include our focus on security; the market transition related to digital transformation and IoT; the transition in cloud; and the move towards more programmable, flexible and virtual networks.

The process of developing new technology, including intent-based networking, more programmable, flexible and virtual networks, and technology related to other market transitions— such as security, digital transformation and IoT, and cloud— is complex and uncertain, and if we fail to accurately predict customers' changing needs and emerging technological trends our business could be harmed. We must commit significant resources, including the investments we have been making in our priorities to developing new products before knowing whether our investments will result in products the market will accept. In particular, if our model of the evolution of networking does not emerge as we believe it will, or if the industry does not evolve as we believe it will, or if our strategy for addressing this evolution is not successful, many of our strategic initiatives and investments may be of no or limited value. For example, if we do not introduce products related to network programmability, such as software-defined-networking products, in a timely fashion, or if product offerings in this market that ultimately succeed are based on technology, or an approach to technology, that differs from ours, such as, for example, networking products based on “white box” hardware, our business could be harmed. Similarly, our business could be harmed if we fail to develop, or fail to develop in a timely fashion, offerings to address other transitions, or if the offerings addressing these other transitions that ultimately succeed are based on technology, or an approach to technology, different from ours. In addition, our business could be adversely affected in periods surrounding our new product introductions if customers delay purchasing decisions to qualify or otherwise evaluate the new product offerings.

Our strategy is to lead our customers in their digital transition with solutions that deliver greater agility, productivity, security and other advanced network capabilities, and that intelligently connect nearly everything that can be connected. Over the last few years, we have been transforming our business to move from selling individual products and services to selling products and services integrated into architectures and solutions, and we are seeking to meet the evolving needs of customers which include offering our products and solutions in the manner in which customers wish to consume them. As a part of this transformation, we continue to make changes to how we are organized and how we build and deliver our technology, including changes in our business models with customers. If our strategy for addressing our customer needs, or the architectures and solutions we develop do not meet those needs, or the changes we are making in how we are organized and how we build and deliver or technology is incorrect or ineffective, our business could be harmed.

Furthermore, we may not execute successfully on our vision or strategy because of challenges with regard to product planning and timing, technical hurdles that we fail to overcome in a timely fashion, or a lack of appropriate resources. This could result in competitors, some of which may also be our strategic alliance partners, providing those solutions before we do and loss of market share, revenue, and earnings. In addition, the growth in demand for technology delivered as a service enables new competitors to enter the market. The success of new products depends on several factors, including proper new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new

products to market in a timely manner, or achieve market acceptance of our products or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive. The products and technologies in our other product categories and key priority and growth areas may not prove to have the market success we anticipate, and we may not successfully identify and invest in other emerging or new products.

CHANGES IN INDUSTRY STRUCTURE AND MARKET CONDITIONS COULD LEAD TO CHARGES RELATED TO DISCONTINUANCES OF CERTAIN OF OUR PRODUCTS OR BUSINESSES, ASSET IMPAIRMENTS AND WORKFORCE REDUCTIONS OR RESTRUCTURINGS

In response to changes in industry and market conditions, we may be required to strategically realign our resources and to consider restructuring, disposing of, or otherwise exiting businesses. Any resource realignment, or decision to limit investment in or dispose

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of or otherwise exit businesses, may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction or restructuring costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Although in certain instances our supply agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed, our loss contingencies may include liabilities for contracts that we cannot cancel with contract manufacturers and suppliers. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions. Additionally, we are required to perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances, and future goodwill impairment tests may result in a charge to earnings. We initiated a restructuring plan in the third quarter of fiscal 2018 and expanded it in the first quarter of fiscal 2019. The implementation of this restructuring plan may be disruptive to our business, and following completion of the restructuring plan our business may not be more efficient or effective than prior to implementation of the plan. Our restructuring activities, including any related charges and the impact of the related headcount restructurings, could have a material adverse effect on our business, operating results, and financial condition.

OVER THE LONG TERM WE INTEND TO INVEST IN ENGINEERING, SALES, SERVICE AND MARKETING ACTIVITIES, AND THESE INVESTMENTS MAY ACHIEVE DELAYED, OR LOWER THAN EXPECTED, BENEFITS WHICH COULD HARM OUR OPERATING RESULTS

While we intend to focus on managing our costs and expenses, over the long term, we also intend to invest in personnel and other resources related to our engineering, sales, service and marketing functions as we realign and dedicate resources on key priority and growth areas, such as Security and Applications, and we also intend to focus on maintaining leadership in Infrastructure Platforms and in Services. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits, and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

OUR BUSINESS SUBSTANTIALLY DEPENDS UPON THE CONTINUED GROWTH OF THE INTERNET AND INTERNET-BASED SYSTEMS

A substantial portion of our business and revenue depends on growth and evolution of the Internet, including the continued development of the Internet and the anticipated market transitions, and on the deployment of our products by customers who depend on such continued growth and evolution. To the extent that an economic slowdown or uncertainty and related reduction in capital spending adversely affect spending on Internet infrastructure, including spending or investment related to anticipated market transitions, we could experience material harm to our business, operating results, and financial condition.

Because of the rapid introduction of new products and changing customer requirements related to matters such as cost-effectiveness and security, we believe that there could be performance problems with Internet communications in the future, which could receive a high degree of publicity and visibility. Because we are a large supplier of networking products, our business, operating results, and financial condition may be materially adversely affected, regardless of whether or not these problems are due to the performance of our own products. Such an event could also result in a material adverse effect on the market price of our common stock independent of direct effects on our business.

WE HAVE MADE AND EXPECT TO CONTINUE TO MAKE ACQUISITIONS THAT COULD DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS

Our growth depends upon market growth, our ability to enhance our existing products, and our ability to introduce new products on a timely basis. We intend to continue to address the need to develop new products and enhance existing products through acquisitions of other companies, product lines, technologies, and personnel. Acquisitions involve numerous risks, including the following:

- Difficulties in integrating the operations, systems, technologies, products, and personnel of the acquired companies, particularly companies with large and widespread operations and/or complex products
- Diversion of management's attention from normal daily operations of the business and the challenges of managing larger and more widespread operations resulting from acquisitions

- Potential difficulties in completing projects associated with in-process research and development intangibles
- Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions

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- Initial dependence on unfamiliar supply chains or relatively small supply partners
- Insufficient revenue to offset increased expenses associated with acquisitions
- The potential loss of key employees, customers, distributors, vendors and other business partners of the companies we acquire following and continuing after announcement of acquisition plans

Acquisitions may also cause us to:

- Issue common stock that would dilute our current shareholders’ percentage ownership
- Use a substantial portion of our cash resources, or incur debt
- Significantly increase our interest expense, leverage and debt service requirements if we incur additional debt to pay for an acquisition
- Assume liabilities
- Record goodwill and intangible assets that are subject to impairment testing on a regular basis and potential periodic impairment charges
- Incur amortization expenses related to certain intangible assets
- Incur tax expenses related to the effect of acquisitions on our legal structure
- Incur large and immediate write-offs and restructuring and other related expenses
- Become subject to intellectual property or other litigation

Mergers and acquisitions of high-technology companies are inherently risky and subject to many factors outside of our control, and no assurance can be given that our previous or future acquisitions will be successful and will not materially adversely affect our business, operating results, or financial condition. Failure to manage and successfully integrate acquisitions could materially harm our business and operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products and technologies to a failure to do so. Even when an acquired company has already developed and marketed products, there can be no assurance that product enhancements will be made in a timely fashion or that pre-acquisition due diligence will have identified all possible issues that might arise with respect to such products.

From time to time, we have made acquisitions that resulted in charges in an individual quarter. These charges may occur in any particular quarter, resulting in variability in our quarterly earnings. In addition, our effective tax rate for future periods is uncertain and could be impacted by mergers and acquisitions. Risks related to new product development also apply to acquisitions. See the risk factors above, including the risk factor entitled “We depend upon the development of new products and enhancements to existing products, and if we fail to predict and respond to emerging technological trends and customers’ changing needs, our operating results and market share may suffer” for additional information.

ENTRANCE INTO NEW OR DEVELOPING MARKETS EXPOSES US TO ADDITIONAL COMPETITION AND WILL LIKELY INCREASE DEMANDS ON OUR SERVICE AND SUPPORT OPERATIONS

As we focus on new market opportunities and key priority and growth areas, we will increasingly compete with large telecommunications equipment suppliers as well as startup companies. Several of our competitors may have greater resources, including technical and engineering resources, than we do. Additionally, as customers in these markets complete infrastructure deployments, they may require greater levels of service, support, and financing than we have provided in the past, especially in emerging countries. Demand for these types of service, support, or financing contracts may increase in the future. There can be no assurance that we can provide products, service, support, and financing to effectively compete for these market opportunities.

Further, provision of greater levels of services, support and financing by us may result in a delay in the timing of revenue recognition. In addition, entry into other markets has subjected and will subject us to additional risks, particularly to those markets, including the effects of general market conditions and reduced consumer confidence. For example, as we add direct selling capabilities globally to meet changing customer demands, we will face increased legal and regulatory requirements.

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INDUSTRY CONSOLIDATION MAY LEAD TO INCREASED COMPETITION AND MAY HARM OUR OPERATING RESULTS

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, some of our current and potential competitors for enterprise data center business have made acquisitions, or announced new strategic alliances, designed to position them with the ability to provide end-to-end technology solutions for the enterprise data center. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results, and financial condition. Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

PRODUCT QUALITY PROBLEMS COULD LEAD TO REDUCED REVENUE, GROSS MARGINS, AND NET INCOME

We produce highly complex products that incorporate leading-edge technology, including both hardware and software. Software typically contains bugs that can unexpectedly interfere with expected operations. There can be no assurance that our pre-shipment testing programs will be adequate to detect all defects, either ones in individual products or ones that could affect numerous shipments, which might interfere with customer satisfaction, reduce sales opportunities, or affect gross margins. From time to time, we have had to replace certain components and provide remediation in response to the discovery of defects or bugs in products that we had shipped. There can be no assurance that such remediation, depending on the product involved, would not have a material impact. An inability to cure a product defect could result in the failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, inventory costs, or product reengineering expenses, any of which could have a material impact on our revenue, margins, and net income. For example, in the second quarter of fiscal 2017 we recorded a charge to product cost of sales of \$125 million related to the expected remediation costs for anticipated failures in future periods of a widely-used component sourced from a third party which is included in several of our products, and in the second quarter of fiscal 2014 we recorded a pre-tax charge of \$655 million related to the expected remediation costs for certain products sold in prior fiscal years containing memory components manufactured by a single supplier between 2005 and 2010.

DUE TO THE GLOBAL NATURE OF OUR OPERATIONS, POLITICAL OR ECONOMIC CHANGES OR OTHER FACTORS IN A SPECIFIC COUNTRY OR REGION COULD HARM OUR OPERATING RESULTS AND FINANCIAL CONDITION

We conduct significant sales and customer support operations in countries around the world. As such, our growth depends in part on our increasing sales into emerging countries. We also depend on non-U.S. operations of our contract manufacturers, component suppliers and distribution partners. Emerging countries in the aggregate experienced a decline in orders in the first quarter of fiscal 2018, in fiscal 2017 and in certain prior periods. We continue to assess the sustainability of any improvements in these countries and there can be no assurance that our investments in these countries will be successful. Our future results could be materially adversely affected by a variety of political, economic or other factors relating to our operations inside and outside the United States, including impacts from global central bank monetary policy; issues related to the political relationship between the United States and other countries that can affect the willingness of customers in those countries to purchase products from companies headquartered in the United States; and the challenging and inconsistent global macroeconomic environment, any or all of which could have a material adverse effect on our operating results and financial condition, including, among others, the following:

- Foreign currency exchange rates
- Political or social unrest

Economic instability or weakness or natural disasters in a specific country or region, including the current economic challenges in China and global economic ramifications of Chinese economic difficulties; instability as a result of

- Brexit; environmental protection measures, trade protection measures such as tariffs, and other legal and regulatory requirements, some of which may affect our ability to import our products, to export our products from, or sell our products in various countries
- Political considerations that affect service provider and government spending patterns
- Health or similar issues, such as a pandemic or epidemic
- Difficulties in staffing and managing international operations

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•Adverse tax consequences, including imposition of withholding or other taxes on our global operations
WE ARE EXPOSED TO THE CREDIT RISK OF SOME OF OUR CUSTOMERS AND TO CREDIT EXPOSURES IN WEAKENED MARKETS, WHICH COULD RESULT IN MATERIAL LOSSES

Most of our sales are on an open credit basis, with typical payment terms of 30 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor individual customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts.

Beyond our open credit arrangements, we have also experienced demands for customer financing and facilitation of leasing arrangements. We expect demand for customer financing to continue, and recently we have been experiencing an increase in this demand as the credit markets have been impacted by the challenging and inconsistent global macroeconomic environment, including increased demand from customers in certain emerging countries.

We believe customer financing is a competitive factor in obtaining business, particularly in serving customers involved in significant infrastructure projects. Our loan financing arrangements may include not only financing the acquisition of our products and services but also providing additional funds for other costs associated with network installation and integration of our products and services.

Our exposure to the credit risks relating to our financing activities described above may increase if our customers are adversely affected by a global economic downturn or periods of economic uncertainty. Although we have programs in place that are designed to monitor and mitigate the associated risk, including monitoring of particular risks in certain geographic areas, there can be no assurance that such programs will be effective in reducing our credit risks.

In the past, there have been significant bankruptcies among customers both on open credit and with loan or lease financing arrangements, particularly among Internet businesses and service providers, causing us to incur economic or financial losses. There can be no assurance that additional losses will not be incurred. Although these losses have not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. A portion of our sales is derived through our distributors. These distributors are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. We maintain estimated accruals and allowances for such business terms. However, distributors tend to have more limited financial resources than other resellers and end-user customers and therefore represent potential sources of increased credit risk, because they may be more likely to lack the reserve resources to meet payment obligations. Additionally, to the degree that turmoil in the credit markets makes it more difficult for some customers to obtain financing, those customers' ability to pay could be adversely impacted, which in turn could have a material adverse impact on our business, operating results, and financial condition.

WE ARE EXPOSED TO FLUCTUATIONS IN THE MARKET VALUES OF OUR PORTFOLIO INVESTMENTS AND IN INTEREST RATES; IMPAIRMENT OF OUR INVESTMENTS COULD HARM OUR EARNINGS

We maintain an investment portfolio of various holdings, types, and maturities. Our portfolio includes available-for-sale debt investments and equity investments, the values of which are subject to market price volatility to the extent unhedged. Available-for-sale debt investments are recorded on our Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a component of accumulated other comprehensive income (loss), net of tax. If such investments suffer market price declines, as we experienced with some of our investments in the past, we may recognize in earnings the decline in the fair value of our investments below their cost basis when the decline is judged to be other than temporary. Securities classified as marketable equity are recorded on our Consolidated Balance Sheets at fair value with gains or losses recorded to interest and other income (loss), net. Our non-marketable equity and other investments are subject to risk of loss of investment capital. These investments are inherently risky because the markets for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire investment in these companies. For information regarding the market risks associated with the fair value of portfolio investments and interest rates, refer to the section titled "Quantitative and Qualitative Disclosures About Market Risk."

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WE ARE EXPOSED TO FLUCTUATIONS IN CURRENCY EXCHANGE RATES THAT COULD NEGATIVELY IMPACT OUR FINANCIAL RESULTS AND CASH FLOWS

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. Historically, our primary exposures have related to nondollar-denominated sales in Japan, Canada, and Australia and certain nondollar-denominated operating expenses and service cost of sales in Europe, Latin America, and Asia, where we sell primarily in U.S. dollars. Additionally, we have exposures to emerging market currencies, which can have extreme currency volatility. An increase in the value of the dollar could increase the real cost to our customers of our products in those markets outside the United States where we sell in dollars and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent that we must purchase components in foreign currencies.

Currently, we enter into foreign exchange forward contracts and options to reduce the short-term impact of foreign currency fluctuations on certain foreign currency receivables, investments, and payables. In addition, we periodically hedge anticipated foreign currency cash flows. Our attempts to hedge against these risks may result in an adverse impact on our net income.

OUR PROPRIETARY RIGHTS MAY PROVE DIFFICULT TO ENFORCE

We generally rely on patents, copyrights, trademarks, and trade secret laws to establish and maintain proprietary rights in our technology and products. Although we have been issued numerous patents and other patent applications are currently pending, there can be no assurance that any of these patents or other proprietary rights will not be challenged, invalidated, or circumvented or that our rights will, in fact, provide competitive advantages to us.

Furthermore, many key aspects of networking technology are governed by industrywide standards, which are usable by all market entrants. In addition, there can be no assurance that patents will be issued from pending applications or that claims allowed on any patents will be sufficiently broad to protect our technology. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as do the laws of the United States. The outcome of any actions taken in these foreign countries may be different than if such actions were determined under the laws of the United States. Although we are not dependent on any individual patents or group of patents for particular segments of the business for which we compete, if we are unable to protect our proprietary rights to the totality of the features (including aspects of products protected other than by patent rights) in a market, we may find ourselves at a competitive disadvantage to others who need not incur the substantial expense, time, and effort required to create innovative products that have enabled us to be successful.

WE MAY BE FOUND TO INFRINGE ON INTELLECTUAL PROPERTY RIGHTS OF OTHERS

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. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents, and the rapid rate of issuance of new patents, it is not economically practical or even possible to determine in advance whether a product or any of its components infringes or will infringe on the patent rights of others. The asserted claims and/or initiated litigation can include claims against us or our manufacturers, suppliers, or customers, alleging infringement of their proprietary rights with respect to our existing or future products or components of those products. Regardless of the merit of these claims, they can be time-consuming, result in costly litigation and diversion of technical and management personnel, or require us to develop a non-infringing technology or enter into license agreements. Where claims are made by customers, resistance even to unmeritorious claims could damage customer relationships. There can be no assurance that licenses will be available on acceptable terms and conditions, if at all, or that our indemnification by our suppliers will be adequate to cover our costs if a claim were brought directly against us or our customers. Furthermore, because of the potential for high court awards that are not necessarily predictable, it is not unusual to find even arguably unmeritorious claims settled for significant amounts. If any infringement or other intellectual property claim made against us by any third party is successful, if we are required to indemnify a customer with respect to a claim against

the customer, 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. For additional information regarding our indemnification obligations, see Note 13(f) to the Consolidated Financial Statements contained in this report.

Our exposure to risks associated with the use of intellectual property may be increased as a result of acquisitions, as we have a lower level of visibility into the development process with respect to such technology or the care taken to safeguard against infringement risks. Further, in the past, third parties have made infringement and similar claims after we have acquired technology that had not been asserted prior to our acquisition.

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WE RELY ON THE AVAILABILITY OF THIRD-PARTY LICENSES

Many of our products are designed to include software or other intellectual property licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to protect our proprietary rights in our products.

OUR OPERATING RESULTS MAY BE ADVERSELY AFFECTED AND DAMAGE TO OUR REPUTATION MAY OCCUR DUE TO PRODUCTION AND SALE OF COUNTERFEIT VERSIONS OF OUR PRODUCTS

As is the case with leading products around the world, our products are subject to efforts by third parties to produce counterfeit versions of our products. While we work diligently with law enforcement authorities in various countries to block the manufacture of counterfeit goods and to interdict their sale, and to detect counterfeit products in customer networks, and have succeeded in prosecuting counterfeiters and their distributors, resulting in fines, imprisonment and restitution to us, there can be no guarantee that such efforts will succeed. While counterfeiters often aim their sales at customers who might not have otherwise purchased our products due to lack of verifiability of origin and service, such counterfeit sales, to the extent they replace otherwise legitimate sales, could adversely affect our operating results.

OUR OPERATING RESULTS AND FUTURE PROSPECTS COULD BE MATERIALLY HARMED BY UNCERTAINTIES OF REGULATION OF THE INTERNET

Currently, few laws or regulations apply directly to access or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as voice over the Internet or using IP, encryption technology, sales or other taxes on Internet product or service sales, and access charges for Internet service providers. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material adverse effect on our business, operating results, and financial condition.

CHANGES IN TELECOMMUNICATIONS REGULATION AND TARIFFS COULD HARM OUR PROSPECTS AND FUTURE SALES

Changes in telecommunications requirements, or regulatory requirements in other industries in which we operate, in the United States or other countries could affect the sales of our products. In particular, we believe that there may be future changes in U.S. telecommunications regulations that could slow the expansion of the service providers' network infrastructures and materially adversely affect our business, operating results, and financial condition, including "net neutrality" rules to the extent they impact decisions on investment in network infrastructure.

Future changes in tariffs by regulatory agencies or application of tariff requirements to currently untariffed services could affect the sales of our products for certain classes of customers. Additionally, in the United States, our products must comply with various requirements and regulations of the Federal Communications Commission and other regulatory authorities. In countries outside of the United States, our products must meet various requirements of local telecommunications and other industry authorities. Changes in tariffs or failure by us to obtain timely approval of products could have a material adverse effect on our business, operating results, and financial condition.

FAILURE TO RETAIN AND RECRUIT KEY PERSONNEL WOULD HARM OUR ABILITY TO MEET KEY OBJECTIVES

Our success has always depended in large part on our ability to attract and retain highly skilled technical, managerial, sales, and marketing personnel. Competition for these personnel is intense, especially in the Silicon Valley area of Northern California. Stock incentive plans are designed to reward employees for their long-term contributions and provide incentives for them to remain with us. Volatility or lack of positive performance in our stock price or equity incentive awards, or changes to our overall compensation program, including our stock incentive program, resulting from the management of share dilution and share-based compensation expense or otherwise, may also adversely affect our ability to retain key employees. As a result of one or more of these factors, we may increase our hiring in

geographic areas outside the United States, which could subject us to additional geopolitical and exchange rate risk. The loss of services of any of our key personnel; the inability to retain and attract qualified personnel in the future; or delays in hiring required personnel, particularly engineering and sales personnel, could make it difficult to meet key objectives, such as timely and effective product introductions. In addition, companies in our industry whose employees accept positions with competitors frequently claim that competitors have engaged in improper hiring practices. We have received these claims in the past and may receive additional claims to this effect in the future.

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Table of Contents**ADVERSE RESOLUTION OF LITIGATION OR GOVERNMENTAL INVESTIGATIONS MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION**

We are a party to lawsuits in the normal course of our business. Litigation can be expensive, lengthy, and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. For example, Brazilian authorities have investigated our Brazilian subsidiary and certain of its former employees, as well as a Brazilian importer of our products, and its affiliates and employees, relating to alleged evasion of import taxes and alleged improper transactions involving the subsidiary and the importer. Brazilian tax authorities have assessed claims against our Brazilian subsidiary based on a theory of joint liability with the Brazilian importer for import taxes, interest, and penalties. The asserted claims by Brazilian federal tax authorities which remain are for calendar years 2003 through 2007, and the asserted claims by the tax authorities from the state of Sao Paulo are for calendar years 2005 through 2007. The total asserted claims by Brazilian state and federal tax authorities aggregate to \$221 million for the alleged evasion of import and other taxes, \$1.4 billion for interest, and \$1.0 billion for various penalties, all determined using an exchange rate as of October 27, 2018. We have completed a thorough review of the matters and believe the asserted claims against our Brazilian subsidiary are without merit, and we are defending the claims vigorously. While we believe there is no legal basis for the alleged liability, due to the complexities and uncertainty surrounding the judicial process in Brazil and the nature of the claims asserting joint liability with the importer, we are unable to determine the likelihood of an unfavorable outcome against our Brazilian subsidiary and are unable to reasonably estimate a range of loss, if any. We do not expect a final judicial determination for several years. An unfavorable resolution of lawsuits or governmental investigations could have a material adverse effect on our business, operating results, or financial condition. For additional information regarding certain of the matters in which we are involved, see Note 13 to the Consolidated Financial Statements, subsection (g) "Legal Proceedings."

CHANGES IN OUR PROVISION FOR INCOME TAXES OR ADVERSE OUTCOMES RESULTING FROM EXAMINATION OF OUR INCOME TAX RETURNS COULD ADVERSELY AFFECT OUR RESULTS

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

OUR BUSINESS AND OPERATIONS ARE ESPECIALLY SUBJECT TO THE RISKS OF EARTHQUAKES, FLOODS, AND OTHER NATURAL CATASTROPHIC EVENTS

Our corporate headquarters, including certain of our research and development operations are located in the Silicon Valley area of Northern California, a region known for seismic activity. Additionally, a certain number of our facilities are located near rivers that have experienced flooding in the past. Also certain of our suppliers and logistics centers are located in regions that have been or may be affected by earthquake, tsunami and flooding activity which in

the past has disrupted, and in the future could disrupt, the flow of components and delivery of products. A significant natural disaster, such as an earthquake, a hurricane, volcano, or a flood, could have a material adverse impact on our business, operating results, and financial condition.

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CYBER-ATTACKS, DATA BREACHES OR MALWARE MAY DISRUPT OUR OPERATIONS, HARM OUR OPERATING RESULTS AND FINANCIAL CONDITION, AND DAMAGE OUR REPUTATION, AND CYBER-ATTACKS OR DATA BREACHES ON OUR CUSTOMERS' NETWORKS, OR IN CLOUD-BASED SERVICES PROVIDED BY OR ENABLED BY US, COULD RESULT IN CLAIMS OF LIABILITY AGAINST US, DAMAGE OUR REPUTATION OR OTHERWISE HARM OUR BUSINESS

Despite our implementation of security measures, the products and services we sell to customers, and our servers, data centers and the cloud-based solutions on which our data, and data of our customers, suppliers and business partners are stored, are vulnerable to cyber-attacks, data breaches, malware, and similar disruptions from unauthorized access or tampering by malicious actors or inadvertent error. Any such event could compromise our products, services, and networks or those of our customers, and the information stored on our systems or those of our customers could be improperly accessed, processed, disclosed, lost or stolen, which could subject us to liability to our customers, suppliers, business partners and others, give rise to legal/regulatory action, and could have a material adverse effect on our business, operating results, and financial condition and may cause damage to our reputation. Efforts to limit the ability of malicious actors to disrupt the operations of the Internet or undermine our own security efforts may be costly to implement and meet with resistance, and may not be successful. Breaches of security in our customers' networks, or in cloud-based services provided by or enabled by us, regardless of whether the breach is attributable to a vulnerability in our products or services, could result in claims of liability against us, damage our reputation or otherwise harm our business.

VULNERABILITIES AND CRITICAL SECURITY DEFECTS, PRIORITIZATION DECISIONS REGARDING REMEDYING VULNERABILITIES OR SECURITY DEFECTS, FAILURE OF THIRD PARTY PROVIDERS TO REMEDY VULNERABILITIES OR SECURITY DEFECTS, OR CUSTOMERS NOT DEPLOYING SECURITY RELEASES OR DECIDING NOT TO UPGRADE PRODUCTS, SERVICES OR SOLUTIONS COULD RESULT IN CLAIMS OF LIABILITY AGAINST US, DAMAGE OUR REPUTATION OR OTHERWISE HARM OUR BUSINESS

The products and services we sell to customers, and our cloud-based solutions, inevitably contain vulnerabilities or critical security defects which have not been remedied and cannot be disclosed without compromising security. We may also make prioritization decisions in determining which vulnerabilities or security defects to fix, and the timing of these fixes, which could result in an exploit which compromises security. Customers also need to test security releases before they can be deployed which can delay implementation. In addition, we rely on third-party providers of software and cloud-based service and we cannot control the rate at which they remedy vulnerabilities. Customers may also not deploy a security release, or decide not to upgrade to the latest versions of our products, services or cloud-based solutions containing the release, leaving them vulnerable. Vulnerabilities and critical security defects, prioritization errors in remedying vulnerabilities or security defects, failure of third-party providers to remedy vulnerabilities or security defects, or customers not deploying security releases or deciding not to upgrade products, services or solutions could result in claims of liability against us, damage our reputation or otherwise harm our business.

TERRORISM AND OTHER EVENTS MAY HARM OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION

The continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the United States and other countries and create further uncertainties or otherwise materially harm our business, operating results, and financial condition. Likewise, events such as loss of infrastructure and utilities services such as energy, transportation, or telecommunications could have similar negative impacts. To the extent that such disruptions or uncertainties result in delays or cancellations of customer orders or the manufacture or shipment of our products, our business, operating results, and financial condition could be materially and adversely affected.

IF WE DO NOT SUCCESSFULLY MANAGE OUR STRATEGIC ALLIANCES, WE MAY NOT REALIZE THE EXPECTED BENEFITS FROM SUCH ALLIANCES AND WE MAY EXPERIENCE INCREASED COMPETITION OR DELAYS IN PRODUCT DEVELOPMENT

We have several strategic alliances with large and complex organizations and other companies with which we work to offer complementary products and services and in the past have established a joint venture to market services associated with our Cisco Unified Computing System products. These arrangements are generally limited to specific projects, the goal of which is generally to facilitate product compatibility and adoption of industry standards. There can be no assurance we will realize the expected benefits from these strategic alliances or from the joint venture. If successful, these relationships may be mutually beneficial and result in industry growth. However, alliances carry an element of risk because, in most cases, we must compete in some business areas with a company with which we have a strategic alliance and, at the same time, cooperate with that company in other business areas. Also, if these companies fail to perform or if these relationships fail to materialize as expected, we could suffer delays in product development or other operational difficulties. Joint ventures can be difficult to manage, given the potentially different interests of joint venture partners.

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OUR STOCK PRICE MAY BE VOLATILE

Historically, our common stock has experienced substantial price volatility, particularly as a result of variations between our actual financial results and the published expectations of analysts and as a result of announcements by our competitors and us. Furthermore, speculation in the press or investment community about our strategic position, financial condition, results of operations, business, security of our products, or significant transactions can cause changes in our stock price. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market price of many technology companies, in particular, and that have often been unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions and the announcement of proposed and completed acquisitions or other significant transactions, or any difficulties associated with such transactions, by us or our current or potential competitors, may materially adversely affect the market price of our common stock in the future. Additionally, volatility, lack of positive performance in our stock price or changes to our overall compensation program, including our stock incentive program, may adversely affect our ability to retain key employees, virtually all of whom are compensated, in part, based on the performance of our stock price.

THERE CAN BE NO ASSURANCE THAT OUR OPERATING RESULTS AND FINANCIAL CONDITION WILL NOT BE ADVERSELY AFFECTED BY OUR INCURRENCE OF DEBT

As of the end of the first quarter of fiscal 2019, we have senior unsecured notes outstanding in an aggregate principal amount of \$25.8 billion that mature at specific dates from calendar year 2019 through 2040. We have also established a commercial paper program under which we may issue short-term, unsecured commercial paper notes on a private placement basis up to a maximum aggregate amount outstanding at any time of \$10.0 billion, and we had no commercial paper notes outstanding under this program as of October 27, 2018. The outstanding senior unsecured notes bear fixed-rate interest payable semiannually, except \$1.0 billion of the notes which bears interest at a floating rate payable quarterly. The fair value of the long-term debt is subject to market interest rate volatility. The instruments governing the senior unsecured notes contain certain covenants applicable to us and our wholly-owned subsidiaries that may adversely affect our ability to incur certain liens or engage in certain types of sale and leaseback transactions. In addition, we will be required to have available in the United States sufficient cash to service the interest on our debt and repay all of our notes on maturity. There can be no assurance that our incurrence of this debt or any future debt will be a better means of providing liquidity to us than would our use of our existing cash resources. Further, we cannot be assured that our maintenance of this indebtedness or incurrence of future indebtedness will not adversely affect our operating results or financial condition. In addition, changes by any rating agency to our credit rating can negatively impact the value and liquidity of both our debt and equity securities, as well as the terms upon which we may borrow under our commercial paper program or future debt issuances.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) None.

(b) None.

(c) Issuer Purchases of Equity Securities (in millions, except per-share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
July 29, 2018 to August 25, 2018	36	\$ 43.98	36	\$ 17,436
August 26, 2018 to September 22, 2018	33	\$ 47.28	33	\$ 15,891
September 23, 2018 to October 27, 2018	40	\$ 46.82	40	\$ 14,010
Total	109	\$ 46.01	109	

On September 13, 2001, we announced that our Board of Directors had authorized a stock repurchase program. On February 14, 2018, our Board of Directors authorized a \$25 billion increase to the stock repurchase program. The remaining authorized amount for stock repurchases under this program, including the additional authorization, is approximately \$14.0 billion, with no termination date.

For the majority of restricted stock units granted, the number of shares issued on the date the restricted stock units vest is net of shares withheld to meet applicable tax withholding requirements. Although these withheld shares are not issued or considered common stock repurchases under our stock repurchase program and therefore are not included in the preceding table, they are treated as common stock repurchases in our financial statements as they reduce the number of shares that would have been issued upon vesting (see Note 14 to the Consolidated Financial Statements).

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

The following documents are filed as exhibits to this report:

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
10.1	<u>Offer Letter, Letter of Transfer and Relocation Payback Agreement by and between Cisco Systems, Inc. and Geraldine Elliott</u>					X
10.2	<u>Offer Letter, Letter of Transfer and Relocation Payback Agreement by and between Cisco Systems, Inc. and Maria Martinez</u>					X
31.1	<u>Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer</u>					X
31.2	<u>Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer</u>					X
32.1	<u>Section 1350 Certification of Principal Executive Officer</u>					X
32.2	<u>Section 1350 Certification of Principal Financial Officer</u>					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

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Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Cisco Systems, Inc.

Date: November 20, 2018 **BS**/ Kelly A. Kramer
Kelly A. Kramer
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer and duly authorized signatory)