

CISCO SYSTEMS, INC.
Form 10-Q
May 24, 2016
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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 April 30, 2016

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 ☐

No ☐

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

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

Large accelerated filer ☒

Accelerated filer

☐

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

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

Yes ☐ No ☒

Number of shares of the registrant's common stock outstanding as of May 19, 2016: 5,029,711,978

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Form 10-Q for the Quarter Ended April 30, 2016

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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)

	April 30, 2016	July 25, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$8,895	\$6,877
Investments	54,617	53,539
Accounts receivable, net of allowance for doubtful accounts of \$244 at April 30, 2016 and \$302 at July 25, 2015	4,047	5,344
Inventories	1,343	1,627
Financing receivables, net	4,716	4,491
Deferred tax assets	2,723	2,915
Other current assets	2,230	1,490
Total current assets	78,571	76,283
Property and equipment, net	3,529	3,332
Financing receivables, net	3,900	3,858
Goodwill	26,762	24,469
Purchased intangible assets, net	2,744	2,376
Other assets	3,148	3,163
TOTAL ASSETS	\$118,654	\$113,481
LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt	\$4,164	\$3,897
Accounts payable	1,007	1,104
Income taxes payable	152	62
Accrued compensation	2,745	3,049
Deferred revenue	9,662	9,824
Other current liabilities	6,273	5,687
Total current liabilities	24,003	23,623
Long-term debt	24,431	21,457
Income taxes payable	891	1,876
Deferred revenue	5,610	5,359
Other long-term liabilities	1,361	1,459
Total liabilities	56,296	53,774
Commitments and contingencies (Note 12)		
Equity:		
Cisco shareholders' equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding	—	—
Common stock and additional paid-in capital, \$0.001 par value: 20,000 shares authorized; 5,034 and 5,085 shares issued and outstanding at April 30, 2016 and July 25, 2015, respectively	44,137	43,592
Retained earnings	18,448	16,045
Accumulated other comprehensive income (loss)	(227)) 61
Total Cisco shareholders' equity	62,358	59,698
Noncontrolling interests	—	9

Total equity	62,358	59,707
TOTAL LIABILITIES AND EQUITY	\$118,654	\$113,481
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		Nine Months Ended	
	April 30, 2016	April 25, 2015	April 30, 2016	April 25, 2015
REVENUE:				
Product	\$8,875	\$9,326	\$27,702	\$27,839
Service	3,125	2,811	8,907	8,479
Total revenue	12,000	12,137	36,609	36,318
COST OF SALES:				
Product	3,214	3,584	10,547	11,309
Service	1,065	1,028	3,077	3,061
Total cost of sales	4,279	4,612	13,624	14,370
GROSS MARGIN	7,721	7,525	22,985	21,948
OPERATING EXPENSES:				
Research and development	1,626	1,547	4,695	4,659
Sales and marketing	2,447	2,449	7,176	7,272
General and administrative	566	510	1,281	1,504
Amortization of purchased intangible assets	81	70	221	213
Restructuring and other charges	17	24	255	411
Total operating expenses	4,737	4,600	13,628	14,059
OPERATING INCOME	2,984	2,925	9,357	7,889
Interest income	270	190	732	558
Interest expense	(175)	(139)	(496)	(417)
Other income (loss), net	4	59	(67)	238
Interest and other income (loss), net	99	110	169	379
INCOME BEFORE PROVISION FOR INCOME TAXES	3,083	3,035	9,526	8,268
Provision for income taxes	734	598	1,600	1,606
NET INCOME	\$2,349	\$2,437	\$7,926	\$6,662
Net income per share:				
Basic	\$0.47	\$0.48	\$1.57	\$1.30
Diluted	\$0.46	\$0.47	\$1.56	\$1.29
Shares used in per-share calculation:				
Basic	5,032	5,102	5,060	5,110
Diluted	5,065	5,148	5,095	5,154
Cash dividends declared per common share	\$0.26	\$0.21	\$0.68	\$0.59
See Notes to Consolidated Financial Statements.				

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)

(Unaudited)

	Three Months Ended April 30, 2016		Nine Months Ended April 30, 2016	
	2015		2015	
Net income	\$2,349	\$2,437	\$7,926	\$6,662
Available-for-sale investments:				
Change in net unrealized gains, net of tax benefit (expense) of \$(146) and \$59 for the three and nine months ended April 30, 2016, respectively, and \$(57) and \$(34) for the corresponding periods of fiscal 2015, respectively	217	72	(95)	80
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$(2) and \$(9) for the three and nine months ended April 30, 2016, and \$16 and \$42 for the corresponding periods of fiscal 2015, respectively	4	(28)	17	(78)
	221	44	(78)	2
Cash flow hedging instruments:				
Change in unrealized gains and losses, net of tax benefit (expense) of \$(2) and \$2 for the three and nine months ended April 30, 2016, respectively, and \$2 and \$8 for the corresponding periods of fiscal 2015, respectively	19	(30)	(1)	(155)
Net (gains) losses reclassified into earnings, net of tax (benefit) expense of \$(2) and \$(4) for the three and nine months ended April 30, 2016, and \$(2) and \$(5) for the corresponding periods of fiscal 2015, respectively	7	62	13	89
	26	32	12	(66)
Net change in cumulative translation adjustment and actuarial gains and losses net of tax benefit (expense) of \$(9) and \$(43) for the three and nine months ended April 30, 2016, respectively, and \$14 and \$50 for the corresponding periods of fiscal 2015, respectively	326	(80)	(231)	(423)
Other comprehensive income (loss)	573	(4)	(297)	(487)
Comprehensive income	2,922	2,433	7,629	6,175
Comprehensive (income) loss attributable to noncontrolling interests	7	5	9	(3)
Comprehensive income attributable to Cisco Systems, Inc.	\$2,929	\$2,438	\$7,638	\$6,172

See Notes to Consolidated Financial Statements.

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

	Nine Months Ended April 30, April 25, 2016 2015	
Cash flows from operating activities:		
Net income	\$7,926	\$6,662
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization, and other	1,546	1,799
Share-based compensation expense	1,101	1,044
Provision for receivables	(27)	82
Deferred income taxes	229	438
Excess tax benefits from share-based compensation	(103)	(102)
(Gains) losses on divestitures, investments and other, net	(279)	(231)
Change in operating assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts receivable	1,412	97
Inventories	189	(235)
Financing receivables	(296)	36
Other assets	(94)	(349)
Accounts payable	(114)	101
Income taxes, net	(723)	(511)
Accrued compensation	(318)	(324)
Deferred revenue	7	217
Other liabilities	(704)	(310)
Net cash provided by operating activities	9,752	8,414
Cash flows from investing activities:		
Purchases of investments	(36,366)	(30,617)
Proceeds from sales of investments	23,806	13,890
Proceeds from maturities of investments	11,790	11,632
Acquisition of businesses, net of cash and cash equivalents acquired	(3,161)	(238)
Proceeds from business divestiture	372	—
Purchases of investments in privately held companies	(202)	(155)
Return of investments in privately held companies	74	274
Acquisition of property and equipment	(880)	(907)
Proceeds from sales of property and equipment	11	8
Other	(195)	(115)
Net cash used in investing activities	(4,751)	(6,228)
Cash flows from financing activities:		
Issuances of common stock	771	1,584
Repurchases of common stock—repurchase program	(3,154)	(3,325)
Shares repurchased for tax withholdings on vesting of restricted stock units	(469)	(415)
Short-term borrowings, original maturities less than 90 days, net	(4)	496
Issuances of debt	6,978	—
Repayments of debt	(3,863)	(507)
Excess tax benefits from share-based compensation	103	102
Dividends paid	(3,441)	(3,017)

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Other	96	40
Net cash used in financing activities	(2,983)	(5,042)
Net increase (decrease) in cash and cash equivalents	2,018	(2,856)
Cash and cash equivalents, beginning of period	6,877	6,726
Cash and cash equivalents, end of period	\$8,895	\$3,870

Supplemental cash flow information:

Cash paid for interest	\$691	\$646
Cash paid for income taxes, net	\$2,093	\$1,680

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF EQUITY

(in millions, except per-share amounts)

(Unaudited)

Nine Months Ended April 30, 2016	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 25, 2015	5,085	\$ 43,592	\$ 16,045	\$ 61	\$ 59,698	\$ 9	\$ 59,707
Net income			7,926		7,926		7,926
Other comprehensive income (loss)				(288)	(288)	(9)	(297)
Issuance of common stock	87	771			771		771
Repurchase of common stock	(120)	(1,036)	(2,082)		(3,118)		(3,118)
Shares repurchased for tax withholdings on vesting of restricted stock units	(18)	(469)			(469)		(469)
Cash dividends declared (\$0.68 per common share)			(3,441)		(3,441)		(3,441)
Tax effects from employee stock incentive plans		32			32		32
Share-based compensation expense		1,101			1,101		1,101
Purchase acquisitions		146			146		146
BALANCE AT APRIL 30, 2016	5,034	\$ 44,137	\$ 18,448	\$ (227)	\$ 62,358	\$ —	\$ 62,358

Nine Months Ended April 25, 2015	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 26, 2014	5,107	\$ 41,884	\$ 14,093	\$ 677	\$ 56,654	\$ 7	\$ 56,661
Net income			6,662		6,662		6,662
Other comprehensive income (loss)				(490)	(490)	3	(487)
Issuance of common stock	123	1,584			1,584		1,584
Repurchase of common stock	(120)	(994)	(2,235)		(3,229)		(3,229)
Shares repurchased for tax withholdings on vesting of restricted stock units	(17)	(415)			(415)		(415)
Cash dividends declared (\$0.59 per common share)			(3,017)		(3,017)		(3,017)
Tax effects from employee stock incentive plans		27			27		27
Share-based compensation expense		1,044			1,044		1,044
Purchase acquisitions		3			3		3
BALANCE AT APRIL 25, 2015	5,093	\$ 43,133	\$ 15,503	\$ 187	\$ 58,823	\$ 10	\$ 58,833

Supplemental Information

In September 2001, the Company's Board of Directors authorized a stock repurchase program. As of April 30, 2016, the Company's Board of Directors had authorized an aggregate repurchase of up to \$112 billion of common stock

under this program with no termination date. For additional information regarding stock repurchase, see Note 13 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impacts on Cisco shareholders' equity are summarized in the following table (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Total Cisco Shareholders' Equity
Repurchases of common stock under the repurchase program	4,563	\$ 23,651	\$ 72,146	\$ 95,797
See Notes to Consolidated Financial Statements.				

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the “Company” or “Cisco”) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2016 is a 53-week fiscal year, and fiscal 2015 was a 52-week fiscal year. The Consolidated Financial Statements include the accounts of Cisco and its subsidiaries. All intercompany accounts and transactions have been eliminated. The Company conducts business globally and is primarily managed on a geographic basis in the following three geographic segments: the Americas; Europe, Middle East, and Africa (EMEA); and Asia Pacific, Japan, and China (APJC).

The accompanying financial data as of April 30, 2016 and for the three and nine months ended April 30, 2016 and April 25, 2015 has been prepared by the Company, 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 25, 2015 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended July 25, 2015.

The Company consolidates its investments in a venture fund managed by SOFTBANK Corp. and its affiliates (“SOFTBANK”) as this is a variable interest entity and the Company is the primary beneficiary. The noncontrolling interests attributed to SOFTBANK are presented as a separate component from the Company’s equity in the equity section of the Consolidated Balance Sheets. SOFTBANK’s share of the earnings in the venture fund 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 April 30, 2016; the results of operations and the statements of comprehensive income for the three and nine months ended April 30, 2016 and April 25, 2015; and the statements of cash flows and equity for the nine months ended April 30, 2016 and April 25, 2015, as applicable, have been made. The results of operations for the three and nine months ended April 30, 2016 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. The Company has evaluated subsequent events through the date that the financial statements were issued.

2. Recent Accounting Pronouncements

Recent Accounting Standards or Updates Not Yet Effective

Revenue Recognition In May 2014, the Financial Accounting Standards Board (FASB) issued an accounting standard update related to revenue from contracts with customers, which will supersede nearly all current U.S. GAAP guidance on this topic and eliminate industry-specific guidance. The underlying principle is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. This accounting standard update, as amended, will be effective for the Company beginning in the first quarter of fiscal 2019. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. Early adoption is permitted, but no earlier than fiscal 2018. The Company expects to adopt this accounting standard update in the first quarter of fiscal 2019, and it is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Consolidation of Certain Types of Legal Entities In February 2015, the FASB issued an accounting standard update that changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2017, and early adoption is permitted. The application of this accounting standard update is not expected to have a material impact on the Company's Consolidated Financial Statements.

Classification of Deferred Taxes In November 2015, the FASB issued an accounting standard update that requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2018, and early adoption is permitted. The accounting standard update is a change in balance sheet presentation only.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2019, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Leases In February 2016, the FASB issued an accounting standard update 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 the Company beginning in the first quarter of fiscal 2020 on a modified retrospective basis, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

Share-Based Compensation In March 2016, the FASB issued an accounting standard update that impacts the accounting for share-based payment transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the Consolidated Statements of Cash Flows. The accounting standard will be effective for the Company beginning the first quarter of fiscal 2018, and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its Consolidated Financial Statements.

3. Acquisitions and Divestitures

The Company completed 12 acquisitions during the nine months ended April 30, 2016. 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
MaintenanceNet	\$ 105	\$ (21)	\$ 65	\$ 61
OpenDNS	545	(9)	61	493
Lancope	410	(34)	121	323
Acano	528	(27)	103	452
Leaba	219	(18)	96	141
Jasper	1,234	5	361	868
CliQr	225	(3)	69	159
Others (five in total)	112	(17)	64	65
Total	\$ 3,378	\$ (124)	\$ 940	\$ 2,562

On August 6, 2015, the Company completed its acquisition of privately held MaintenanceNet, Inc.

("MaintenanceNet"), a provider of a cloud-based software platform that uses data analytics and automation to manage renewals of recurring customer contracts. This acquisition is a component of the Company's strategy for its Services organization to simplify and digitize its business processes.

On August 26, 2015, the Company completed its acquisition of privately held OpenDNS, Inc. ("OpenDNS"), a provider of advanced threat protection for endpoint devices. With the OpenDNS acquisition, the Company aims to strengthen its security offerings by adding broad visibility and threat intelligence delivered through a software-as-a-service platform. Revenue from the OpenDNS acquisition has been included in the Company's Security product category.

On December 21, 2015, the Company completed its acquisition of privately held Lancope, Inc. ("Lancope"), a provider of network behavior analytics, threat visibility, and security intelligence. With the Lancope acquisition, the Company aims to advance its "security everywhere" strategy with an additional capability of network behavior analytics that extend protection further into the network. Revenue from the Lancope acquisition has been included in the Company's Security product category.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

On January 29, 2016, the Company completed its acquisition of privately held, London-based Acano (UK) Limited ("Acano"), a collaboration infrastructure and conferencing software provider. With the Acano acquisition, the Company aims to enhance its collaboration strategy to deliver video across both cloud and hybrid environments. Revenue from the Acano acquisition has been included in the Company's Collaboration product category.

On March 3, 2016, the Company completed its acquisition of privately held Leaba Semiconductor, Ltd. ("Leaba"), an Israeli-based fabless semiconductor provider whose semiconductor expertise is expected to be leveraged to accelerate the Company's next-generation product portfolio. This acquisition is a component of the Company's strategy to enhance its product offerings in the networking chipset market.

On March 18, 2016, the Company completed its acquisition of privately held Jasper Technologies, Inc. ("Jasper"), a provider of a cloud-based Internet of Things (IoT) software-as-a-service platform to help enterprises and service providers launch, manage, and monetize IoT services on a global scale. With the Jasper acquisition, the Company aims to offer an IoT solution that is interoperable across devices and works with IoT service providers, application developers, and an ecosystem of partners. Revenue from the Jasper acquisition has been included in the Company's Other product category.

On April 15, 2016, the Company completed its acquisition of privately held CliQr Technologies, Inc. ("CliQr"), an application-defined cloud orchestration platform provider. With the CliQr acquisition, the Company aims to help its customers simplify and accelerate their private, public, and hybrid cloud deployments.

The total purchase consideration related to the Company's acquisitions completed during the nine months ended April 30, 2016 consisted of cash consideration and the assumption of vested share-based awards. The total cash and cash equivalents acquired from these business combinations was approximately \$44 million. Total transaction costs related to the Company's acquisition activities were \$29 million and \$5 million for the nine months ended April 30, 2016 and April 25, 2015, respectively. These transaction costs were expensed as incurred in general and administrative expenses ("G&A") in the Consolidated Statements of Operations.

The Company's 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 the Company may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Adjustments in the purchase price allocation may require a recasting of the amounts allocated to goodwill retroactive to the period in which the acquisition occurred.

The goodwill generated from the Company's acquisitions completed during the nine months ended April 30, 2016 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 for the acquisitions completed during the nine months ended April 30, 2016 have not been presented because the effects of the acquisitions, individually and in the aggregate, were not material to the Company's financial results.

Divestiture of SP Video CPE Business On November 20, 2015, the Company completed the sale of the assets comprising the customer premises equipment portion of its Service Provider Video connected devices business ("SP Video CPE Business") to Technicolor SA. As a result of the transaction, the Company received aggregate consideration of \$542 million consisting of \$372 million in cash and \$170 million in Technicolor stock (as of the divestiture date) and the transaction resulted in a gain of \$285 million, net of certain transaction costs incurred to date.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

4. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the goodwill allocated to the Company's reportable segments as of and during the nine months ended April 30, 2016 (in millions):

	Balance at July 25, 2015	Acquisitions	Divestiture	Other	Balance at April 30, 2016
Americas	\$15,212	\$ 1,607	\$ (126)	\$(80)	\$16,613
EMEA	5,791	554	(12)	(31)	6,302
APJC	3,466	401	(3)	(17)	3,847
Total	\$24,469	\$ 2,562	\$ (141)	\$(128)	\$26,762

"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 the Company's intangible assets acquired through acquisitions completed during the nine months ended April 30, 2016 (in millions, except years):

	FINITE LIVES				INDEFINITE LIVES		TOTAL
	TECHNOLOGY		CUSTOMER RELATIONSHIPS		OTHER	IPR&D	
	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount
MaintenanceNet	5.0	\$ 50	5.0	\$ 2	2.0	\$ 2	\$ 11
OpenDNS	5.0	43	7.0	15	1.0	2	1
Lancopé	5.0	79	6.0	29	3.0	3	10
Acano	5.0	9	5.0	12	0.0	—	82
Leaba	0.0	—	0.0	—	0.0	—	96
Jasper	6.0	240	7.0	75	2.0	23	23
CliQr	6.0	65	6.0	3	2.0	1	—
Others (five in total)	4.1	58	6.3	6	0.0	—	—
Total		\$ 544		\$ 142		\$ 31	\$ 223

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

April 30, 2016	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,103	\$(1,297)	\$1,806
Customer relationships	1,821	(1,156)	665
Other	85	(36)	49
Total purchased intangible assets with finite lives	5,009	(2,489)	2,520
In-process research and development, with indefinite lives	224	—	224
Total	\$5,233	\$(2,489)	\$2,744

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

July 25, 2015	Gross	Accumulated Amortization	Net
Purchased intangible assets with finite lives:			
Technology	\$3,418	\$ (1,818)	\$ 1,600
Customer relationships	1,699	(971)	728
Other	55	(24)	31
Total purchased intangible assets with finite lives	5,172	(2,813)	2,359
In-process research and development, with indefinite lives	17	—	17
Total	\$5,189	\$ (2,813)	\$ 2,376

Purchased intangible assets include intangible assets acquired through acquisitions as well as through direct purchases or licenses. In fiscal 2015, the Company, along with a number of other companies, entered into an agreement to obtain a license to the patents owned by the Rockstar Consortium, and the Company paid approximately \$300 million, of which \$188 million was expensed to product cost of sales in the first quarter of fiscal 2015 related to the settlement of patent infringement claims, and the remainder was capitalized as an intangible asset to be amortized over its estimated useful life.

Impairment charges related to purchased intangible assets for the three months ended April 30, 2016 and April 25, 2015 were \$7 million and \$1 million, respectively. Impairment charges related to purchased intangible assets for the nine months ended April 30, 2016 and April 25, 2015 were \$44 million and \$57 million, respectively.

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

	Three Months Ended April 30, 2016		Nine Months Ended April 30, 2016	
	2015		2015	
Amortization of purchased intangible assets:				
Cost of sales	\$ 134	\$ 187	\$ 419	\$ 618
Operating expenses	81	70	221	213
Total	\$ 215	\$ 257	\$ 640	\$ 831

The estimated future amortization expense of purchased intangible assets with finite lives as of April 30, 2016 is as follows (in millions):

Fiscal Year	Amount
2016 (remaining three months)	\$ 211
2017	742
2018	595
2019	502
2020	276
Thereafter	194
Total	\$ 2,520

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5. Restructuring and Other Charges

Fiscal 2015 Plan The Company announced a restructuring action in August 2014 (the "Fiscal 2015 Plan"), in order to realign its workforce towards key growth areas of its business such as data center, software, security, and cloud. The Company's aggregate pre-tax estimated charges pursuant to the restructuring plan are expected to be approximately \$750 million, consisting of severance and other one-time termination benefits and other associated costs, and the Company has incurred cumulative charges of approximately \$743 million in connection with this plan, which is substantially complete. The Company incurred charges of \$18 million and \$24 million for the three months ended April 30, 2016 and April 25, 2015, respectively, and \$254 million, net of a \$2 million credit to cost of sales, and \$411 million for the nine months ended April 30, 2016 and April 25, 2015, respectively.

Fiscal 2014 Plan In connection with a restructuring action announced in August 2013 (the "Fiscal 2014 Plan"), the Company incurred cumulative charges of approximately \$417 million, of which a \$1 million credit was recognized during the three and nine months ended April 30, 2016. No charges were incurred in the corresponding periods of fiscal 2015. The Company completed the Fiscal 2014 Plan at the end of fiscal 2014.

The following table summarizes the activities related to the restructuring and other charges as discussed above (in millions):

	FISCAL 2014 PLAN		FISCAL 2015 PLAN		
	Employee Severance	Other	Employee Severance	Other	Total
Liability as of July 25, 2015	\$11	\$14	\$49	\$15	\$89
Charges	—	(1)	224	32	255
Cash payments	(11)	(3)	(227)	(10)	(251)
Non-cash items	—	—	—	(21)	(21)
Liability as of April 30, 2016	\$—	\$10	\$46	\$16	\$72

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(Unaudited)

6. Balance Sheet Details

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

	April 30, July 25,	
	2016	2015
Inventories:		
Raw materials	\$ 108	\$ 114
Work in process	—	2
Finished goods:		
Distributor inventory and deferred cost of sales	513	610
Manufactured finished goods	469	593
Total finished goods	982	1,203
Service-related spares	234	258
Demonstration systems	19	50
Total	\$ 1,343	\$ 1,627
Property and equipment, net:		
Gross property and equipment:		
Land, buildings, and building and leasehold improvements	\$4,706	\$4,495
Computer equipment and related software	1,384	1,310
Production, engineering, and other equipment	5,700	5,753
Operating lease assets	325	372
Furniture and fixtures	527	497
Total gross property and equipment	12,642	12,427
Less: accumulated depreciation and amortization	(9,113)	(9,095)
Total	\$3,529	\$3,332
Other assets:		
Deferred tax assets	\$1,345	\$1,648
Investments in privately held companies	976	897
Other	827	618
Total	\$3,148	\$3,163
Deferred revenue:		
Service		\$9,866 \$9,757
Product:		
Unrecognized revenue on product shipments and other deferred revenue	4,987	4,766
Cash receipts related to unrecognized revenue from two-tier distributors	419	660
Total product deferred revenue	5,406	5,426
Total	\$15,272	\$15,183
Reported as:		
Current		\$9,662 \$9,824
Noncurrent		5,610 5,359
Total		\$15,272 \$15,183

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CISCO SYSTEMS, INC.

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(Unaudited)

7. Financing Receivables and Operating Leases

(a) Financing Receivables

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

A summary of the Company's financing receivables is presented as follows (in millions):

April 30, 2016	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Gross	\$ 3,245	\$ 2,223	\$ 3,504	\$8,972
Residual value	205	—	—	205
Unearned income	(178)	—	—	(178)
Allowance for credit loss	(250)	(93)	(40)	(383)
Total, net	\$ 3,022	\$ 2,130	\$ 3,464	\$8,616
Reported as:				
Current	\$ 1,495	\$ 1,052	\$ 2,169	\$4,716
Noncurrent	1,527	1,078	1,295	3,900
Total, net	\$ 3,022	\$ 2,130	\$ 3,464	\$8,616
July 25, 2015	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Gross	\$ 3,361	\$ 1,763	\$ 3,573	\$8,697
Residual value	224	—	—	224
Unearned income	(190)	—	—	(190)
Allowance for credit loss	(259)	(87)	(36)	(382)
Total, net	\$ 3,136	\$ 1,676	\$ 3,537	\$8,349
Reported as:				
Current	\$ 1,468	\$ 856	\$ 2,167	\$4,491
Noncurrent	1,668	820	1,370	3,858
Total, net	\$ 3,136	\$ 1,676	\$ 3,537	\$8,349

As of April 30, 2016 and July 25, 2015, the deferred service revenue related to "Financed Service Contracts and Other" was \$1,822 million and \$1,853 million, respectively.

Future minimum lease payments to the Company on lease receivables as of April 30, 2016 are summarized as follows (in millions):

Fiscal Year	Amount
2016 (remaining three months)	\$ 408
2017	1,430

2018	833
2019	402
2020	152
Thereafter	20
Total	\$ 3,245

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(b) Credit Quality of Financing Receivables

Gross receivables, excluding residual value, less unearned income categorized by the Company's internal credit risk rating as of April 30, 2016 and July 25, 2015 are summarized as follows (in millions):

INTERNAL CREDIT RISK RATING				
April 30, 2016	1 to 4	5 to 6	7 and Higher	Total
Lease receivables	\$1,677	\$1,276	\$ 114	\$3,067
Loan receivables	991	1,079	153	2,223
Financed service contracts and other	2,216	1,242	46	3,504
Total	\$4,884	\$3,597	\$ 313	\$8,794

INTERNAL CREDIT RISK RATING				
July 25, 2015	1 to 4	5 to 6	7 and Higher	Total
Lease receivables	\$1,688	\$1,342	\$ 141	\$3,171
Loan receivables	788	823	152	1,763
Financed service contracts and other	2,133	1,389	51	3,573
Total	\$4,609	\$3,554	\$ 344	\$8,507

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

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

In circumstances when collectibility is not deemed reasonably assured, the associated revenue is deferred in accordance with the Company's revenue recognition policies, and the related allowance for credit loss, if any, is included in deferred revenue. The Company also records deferred revenue associated with financing receivables when there are remaining performance obligations, as it does for financed service contracts. Total allowances for credit loss and deferred revenue as of April 30, 2016 and July 25, 2015 were \$2,225 million and \$2,253 million, respectively, and they were associated with total financing receivables before allowance for credit loss of \$8,999 million and \$8,731 million as of their respective period ends.

The following tables present the aging analysis of gross receivables, excluding residual value and less unearned income as of April 30, 2016 and July 25, 2015 (in millions):

DAYS PAST DUE (INCLUDES BILLED AND UNBILLED)									
April 30, 2016	31-60	61-90	91+	Total Past Due	Current	Total	Nonaccrual Financing Receivables	Impaired Financing Receivables	
Lease receivables	\$41	\$ 44	\$181	\$ 266	\$2,801	\$3,067	\$ 67	\$ 65	
Loan receivables	51	11	78	140	2,083	2,223	47	47	
Financed service contracts and other	79	115	237	431	3,073	3,504	36	16	
Total	\$171	\$170	\$496	\$ 837	\$7,957	\$8,794	\$ 150	\$ 128	
DAYS PAST DUE (INCLUDES BILLED AND UNBILLED)									

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July 25, 2015	31-60	61-90	91+	Total Past Due	Current	Total	Nonaccrual Financing Receivables	Impaired Financing Receivables
Lease receivables	\$90	\$ 27	\$185	\$ 302	\$2,869	\$3,171	\$ 73	\$ 73
Loan receivables	21	3	25	49	1,714	1,763	32	32
Financed service contracts and other	396	152	414	962	2,611	3,573	29	9
Total	\$507	\$ 182	\$624	\$ 1,313	\$7,194	\$8,507	\$ 134	\$ 114

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

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of either unbilled or current financing receivables included in the category of 91 days plus past due for financing receivables were \$298 million and \$496 million as of April 30, 2016 and July 25, 2015, respectively.

As of April 30, 2016, the Company had financing receivables of \$165 million, net of unbilled or current receivables from the same contract, 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 \$70 million as of July 25, 2015.

(c) Allowance for Credit Loss Rollforward

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

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Three months ended April 30, 2016				
Allowance for credit loss as of January 23, 2016	\$248	\$ 80	\$ 37	\$365
Provisions	7	8	2	17
Recoveries (write-offs), net	(6)	—	—	(6)
Foreign exchange and other	1	5	1	7
Allowance for credit loss as of April 30, 2016	\$250	\$ 93	\$ 40	\$383

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Nine months ended April 30, 2016				
Allowance for credit loss as of July 25, 2015	\$259	\$ 87	\$ 36	\$382
Provisions	3	2	7	12
Recoveries (write-offs), net	(10)	—	(4)	(14)
Foreign exchange and other	(2)	4	1	3
Allowance for credit loss as of April 30, 2016	\$250	\$ 93	\$ 40	\$383

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Three months ended April 25, 2015				
Allowance for credit loss as of January 24, 2015	\$250	\$ 85	\$ 40	\$375
Provisions	(4)	(5)	(2)	(11)
Recoveries (write-offs), net	(1)	—	—	(1)
Foreign exchange and other	(3)	—	(1)	(4)
Allowance for credit loss as of April 25, 2015	\$242	\$ 80	\$ 37	\$359

	CREDIT LOSS ALLOWANCES			
	Lease Receivables	Loan Receivables	Financed Service Contracts and Other	Total
Nine months ended April 25, 2015				
Allowance for credit loss as of July 26, 2014	\$233	\$ 98	\$ 18	\$349
Provisions	25	(15)	21	31
Recoveries (write-offs), net	(6)	1	—	(5)
Foreign exchange and other	(10)	(4)	(2)	(16)
Allowance for credit loss as of April 25, 2015	\$242	\$ 80	\$ 37	\$359

The Company assesses the allowance for credit loss related to financing receivables on either an individual or a collective basis. The Company considers various factors in evaluating lease and loan receivables and the earned portion of financed service contracts for possible impairment on an individual basis. These factors include the Company's historical experience, credit quality and age of the receivable balances, and economic conditions that may affect a customer's ability to pay. When the evaluation indicates that it is probable that all amounts due pursuant to the contractual terms of the financing agreement, including scheduled interest payments, are unable to be collected, the financing receivable is considered impaired. All such outstanding amounts, including

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any accrued interest, will be assessed and fully reserved at the customer level. The Company's internal credit risk ratings are categorized as 1 through 10, with the lowest credit risk rating representing the highest quality financing receivables.

Typically, the Company also considers receivables with a risk rating of 8 or higher to be impaired and will include them in the individual assessment for allowance. These balances, as of April 30, 2016 and July 25, 2015, are presented under "(b) Credit Quality of Financing Receivables" above.

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

(d) Operating Leases

The Company provides 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):

	April 30, July 25,	
	2016	2015
Operating lease assets	\$ 325	\$ 372
Accumulated depreciation (184)	(205)	
Operating lease assets, net	\$ 141	\$ 167

Minimum future rentals on noncancelable operating leases as of April 30, 2016 are summarized as follows (in millions):

Fiscal Year	Amount
2016 (remaining three months)	\$ 54
2017	189
2018	129
2019	39
2020	8
Thereafter	5
Total	\$ 424

8. Investments**(a) Summary of Available-for-Sale Investments**

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

April 30, 2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
U.S. government securities	\$ 24,003	\$ 44	\$ (3)	\$ 24,044
U.S. government agency securities	2,883	5	—	2,888
Non-U.S. government and agency securities	1,063	2	—	1,065
Corporate debt securities	23,193	160	(37)	23,316
U.S. agency mortgage-backed securities	1,746	16	—	1,762
Total fixed income securities	52,888	227	(40)	53,075
Publicly traded equity securities	1,354			