These prepared remarks should be viewed solely in conjunction with the related quarter's conference call webcast and press release, which can be found here. The webcast includes the prepared remarks as well as a question and answer session.

Please click here for complete GAAP reconciliation information between our GAAP financial results and our non-GAAP financial results.

Cisco Systems, Inc.
Q2 FY 2012 Earnings Conference Call
Wednesday, February 8, 2012
1:30pm PT

Introduction

Welcome to Cisco Systems second quarter and fiscal year 2012 financial results conference call. At the request of Cisco Systems, today's conference is being recorded. If you have any objections, you may disconnect.

Now I would like to introduce Melissa Selcher, Senior Director Corporate Communications and Investor Relations. Ma'am, you may begin.

Thank you. Good afternoon, everyone, and welcome to our 88th quarterly conference call. This is Melissa Selcher, Senior Director of Analyst and Investor Relations, and I am joined by John Chambers, our Chairman and Chief Executive Officer; Frank Calderoni, Executive Vice President and Chief Financial Officer; Rob Lloyd, Executive Vice President of Worldwide Operations; and Gary Moore, Executive Vice President and Chief Operating Officer.

The Q2 fiscal year 2012 press release is on US High Tech Marketwire and on the Cisco website at http://newsroom.cisco.com. I would like to remind you that we have a corresponding webcast with slides. In those slides you will find financial information that we cover during this conference call, as well as additional financial metrics and analysis that you might find helpful.

Additionally, downloadable Q2 financial statements will be available following the call, in the Investor Relations section of our website, including revenue and gross margin by geographic segments, as well as revenue by product categories. Income statements, full GAAP to non-GAAP reconciliation information, balance sheets, and cash flow statements can also be found on our website in the Investor Relation section. Click on the financial reporting section of the website to access the webcast slides and these documents.

An audio replay of this call will be available from February 8th through February 15th, at 866-493-8039 or 203-369-1749 for international callers. A webcast replay is available from February 8th through April 20th, on Cisco's Investor Relations website at http://investor.cisco.com.

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results. The financial results in the press release are unaudited. The matters we will be discussing today include forward-looking statements and as such are subject to the risks and uncertainties that we discuss in detail in our documents filed with the SEC, specifically the most recent reports on form 10Q and 10K and any applicable amendments which identify important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements. Unauthorized recording of this conference call is not permitted.

I will now turn it over to John for his commentary on the quarter.

Opening Remarks

Mel, thank you very much. Over the last several quarters, we've continued to make consistent, major progress on our comprehensive action plan to position ourselves for the next stage of our growth and profitability. Q2 was a very solid quarter in terms of this continued progress, with record revenues and earnings per share, both GAAP and non-GAAP.

We grew profits faster than revenues, and we achieved our $1 billion expense reduction targets one quarter ahead of schedule. Our value to our customers continues to increase as we focus on catching the major market transitions occurring in our industry sector.

By focusing on our five foundational priorities of core networking, datacenter cloud, video, collaboration, and business architectures, we are positioned to lead across the most significant market transitions in our industry that our industry is facing today. These market transitions represent our customers most important care abouts, including mobility, cloud, BYOD, or bring your own device, and the reality of pervasive video driven by new collaboration and social networking solutions. Each of these transitions require the increased value of intelligent networks along with technology architectures that enable both better performance and integrative products, software, and services.

By building on Cisco's intelligent network, our customers are innovating and solving their toughest business problems. We believe our vision and strategy are working and Cisco's value to our customers is increasing. We appear to also be gaining an increasing share of our customers' total spend on IT, as evidenced by our revenue growth versus many of our peers and competitors. The bottom line for Cisco is simple – innovation, speed, and agility are in, cost and complexity are out.

In the initial part of this call, I will first provide a high-level financial review then cover our progress and results and how they relate to executing on our three-year plan that we believe will drive the future of Cisco and of our intelligent networks. Second, we will give an update on Q2 progress with regards to our five foundational priorities. And third, we will cover the order momentum in each of our three geographic regions and four customer segments. Those segments are enterprise, public sector, commercial, and service provider. And finally, we will provide Q3 FY12 revenue guidance.

In the second part of the conference call, Frank will go into more detail from a financial perspective, as well as expand on our Q3 guidance. I will then make some summary comments regarding perspective on Q2, as well as our momentum for the second half of the fiscal year, followed by Q&A.

First, we continue to make very solid progress in Q2, both in terms of our results and execution in the second quarter of our three-year plan. Our performance in Q2 exceeded the guidance we provided last quarter for both revenues and earnings per share. We had record quarterly revenue of $11.5 billion, an 11% increase year-over-year, compared to our guidance of 7% to 8%.

Non-GAAP earnings per share was a record $0.47, again above our guidance, a year-over-year increase of 27%. GAAP earnings per share was also a record at $0.40, a year-over-year increase of 48%. Non-GAAP total gross margins were 62.4%, a little higher than our original expectations, while non-GAAP product gross margins were 60.9%. Our entire company continues to focus on gross margin improvement.

While revenue and earnings per share in Q2 were solid, we were especially pleased with our non-GAAP and GAAP net income, growing 23% and 43% respectively, year-over-year, representing the revenue increase of 11%.

We achieved our goal of $1 billion expense reductions, measured from a quarterly run-rate perspective in Q2, one quarter earlier than our stated goals. Overall product book-to-bill was approximately one. Total product orders grew 7% year-over-year. As a reminder, in Q2 of last fiscal year, FY11, our product book-to-bill was greater than one.

We are a very strong company with a very strong balance sheet, solid customer relationships, and leadership in many healthy markets. However, we will continue to address a few areas for improvement, with the power of the entire company focused on these improvements.

We've organized our business around our customers' buying patterns and with a focus on their most important business transitions. These transitions are leading to a convergence of our products and solutions, as well as our customer segments - enterprise, service provider, commercial and public sector. These are no longer distinct silos at Cisco.

During Q2, we continue to see how the restructuring and organizational changes benefit our customers and our shareholders.

Our US enterprise performance is a strong example of how our shift is working. The close rate in this business in terms of the pipeline of the sales organization, is nearly twice as high when we're talking about business technology and business budgets versus just IT budgets. We are continuing to expand our ability to sell solutions and innovation that align to our customers' business opportunities and problems.

The market transition from information technology to business technology, based on architectural approaches, appears to be playing out pretty much as outlined in our vision and strategy. We are in the sweet spot of where our customers are focusing their efforts, whether it is in innovation, cost reductions, productivity, business transformation, or revenue growth.

Our customers' goals often tie one-to-one to our five foundational priorities, and our customers are increasingly understanding this differentiation. The results appear to be that we are getting a higher share of the total IT spend versus many of our peers and competitors. In my opinion, the franchise value that Cisco represents is continuing to expand. Most of our customers just expect us to continue to innovate and change with industry trends, customer needs, and to get in front of the major technology shifts, and to expand the partnership with them in doing the same in their respective industries. And we believe we are accomplishing this goal at an accelerated rate.

When I look back at the last two to three quarters, the steadfast commitment of our people to adapt to rapid change and continue to execute against market demands, reflects the intangible value of Cisco - the ability of a $45 billion dollar revenue company to turn quickly and move forward, not weaker, but much stronger. Our goal is simply to continue this pace of consistent improvement.

Of particular importance to me is the feedback that we are receiving from the meetings that we have around the world with enterprise CEOs, CIOs, SPs, CEOs, CTOs, and government leaders. They understand the importance of the transitions we made, and strongly agree with our strategy and direction. At the World Economic Forum, we met with over 100 of our top customers, ranging from government leaders, service providers, enterprise, partners, etc. And I can say that I believe, almost without exception, we are gaining mind share, and most of the time wallet share.

Update on our Priorities

Second, I would like to provide an update on our five foundational priorities, which we believe will be the key in both the growth of the Internet and also in our differentiation and total cost of ownership proposition versus our peers in the industry. These five foundational priorities are the key drivers of the future of the network and the core Internet. They are, in my opinion, not only the most important and difficult elements in intelligent networking, but at the same time the hardest to provide true integrated leadership.

Our customers know Cisco is uniquely able to deliver in these areas to support their business success and protect as much as possible their investment, flexibility, and future innovation capabilities from both a technology and a new business model perspective. The first foundational priority is leadership in our core. And as a reminder, core to us means routing, switching, and services. Q2 updates will be provided in terms of revenue from a year-over-year perspective in each of these five foundational priorities.

Total switching grew 8% in terms of revenue. We have continued to focus aggressively on gross margins, and as such, achieved additional improvements in gross margins in switching, although there's still room for continuous improvement. As a note of interest, our switching gross margins in Q2 have returned to where they were approximately two years ago. For example, our Nexus portfolio switches introduced a little bit over a year ago showed an improvement in terms of gross margins in this last year of about over 800 basis points from a year-ago. We are continuing to see the ability in our switching portfolio from an order, market share, and gross margin perspective.

Our total NGN routing grew 8% in terms of revenue. High-end routing grew 11% in terms of revenue. Mid- to low-end routing grew 6% in revenues. Routing gross margins were up about three percentage points versus Q1, but we need to continue to focus in this area.

We appear to again be gaining market share in routing versus many of our competitors. For example, in the most recent quarter, one of our major routing competitors reported routing product revenue being down over 20% year-over-year.

Services grew 11% in terms of revenues year-over-year. Gary, just a continued nice job by your team.

As we continue to expand on our architectural approach, focusing more on solutions and selling to the business side of our customers' organization, services will continue to play an increasing role and be an increasing percentage of our total sales.

Second, the datacenter. It is evolving from bare metal to virtualization to the cloud. The results in this area have been particularly outstanding, given that we are taking on big competitors in the datacenter, as we focus on the market transition with the convergence of server, networking, and storage in the cloud. Our UCS products grew year-over-year at 91% in terms of revenue. Even though the Nexus 2000 and 5000 are included in our switching product summaries not the datacenter, they are obviously tightly tied to the UCS server technology. Again, you saw the Nexus 2000 and 5000 combined revenue growth of over 100% year-over-year. We added 1,786 new UCS customers in Q2, bringing the total to 10,763.

The third priority is collaboration, which represents major productivity opportunities in a wide variety of our customers and all industries. Collaboration, which had some tough comparisons in terms of year-over-year, grew revenues by 10%. TelePresence, which is included in collaboration and not in video, was up 19% in terms of revenue.

Fourth, our video strategy is in very good shape. We have by far and away the strongest end-to-end architecture for video, going from the cloud to the end device, regardless of what that end device is, enabled by media net architecture and our Videoscape platform. This makes video much more practical, easier to use, and easier to consume. Along with the cloud and mobility, video is one of the most significant transitions our service providers and enterprise customers are experiencing.

Following a very strong Q1, SP Video had another very strong quarter with 23% revenue growth year-over-year. In terms of our set top boxes, we are very much committed to this marketplace. Our service provider customers ask us to partner with them as they move from the traditional set top boxes to IP set top boxes to the cloud in our Videoscape solution.

Receptivity so far as been very, very good in terms of our strategy. We have demonstrated our capability to bring video to large volumes of any combination of devices, whether these devices are Cisco, our peers, or even our competitors. The following video data illustrates the pervasive video growth that is occurring in the market. Our emerging video technologies grew at 59% from a revenue perspective, and gross margins have improved dramatically by over 20% in the last year. These areas include physical security, media experience, analytics BU, et cetera.

Fifth, architectures for business transformation. Our technology architectures are gaining momentum across our enterprise public sector, commercial and service provider customers. These customers recognize the value of an integrated network architecture and the many important factors of an architectural approach, including increased reliability and security, products actually designed to work together, ease of addressing new business demands, and the ability to adopt new technology trends faster, such as cloud, video, and mobility.

We are also rapidly improving our ability to translate for our customers how technology architectures enable them to achieve their most important and yet most challenging business goals by presenting - Rob, what I think you coined, as the whole offer to our customers - combining products, intelligent networks, services, and solutions.

In summary, we are moving ahead of our competitors and our industry peers. You can see this in our market share gains, our reported results compared to others, and there is significant anecdotal evidence that customers are embracing our strategy.

This leads us to believe that the changes we have already made in our business, not only positions us well given the uncertainties in the macroeconomic environment, but are also resulting in Cisco capturing a larger share of our customers' spend.

We've been most successful when we capture market transitions, if you will, tipping points or inflection points in our industry. As I explained earlier, we believe a number of these are occurring at the same time, and our intelligent network is key to helping our customers solve their toughest business issues as they navigate through these transitions.

Perhaps what I'm most proud of from this quarter is the balance between operational excellence and innovation. What I find remarkable for a $45 billion company is our ability to innovate with a sense of urgency. For example, last year we simultaneously refreshed practically our entire switching portfolio, which is the largest ever product portfolio refresh in such a short period of time. This significantly drove down price performance to the benefit of our customers, and today our shareholders see the benefits of that in our reported numbers, both from a revenue and a gross profit perspective.

In addition, over the last two years, we disrupted the server market with a unique offering, and created a $1 billion product line that grew over 91% this quarter from a revenue perspective. On a larger scale of disruptive industry innovations, an example is our ability to anticipate the evolution of the datacenter, going from bare metal to virtualization to the cloud. We started on this over six years ago, and it's our ability to evolve this to where we are today that sets us apart from many of our peers.

This innovation combining the server products with our top-of-rack capability, our storage strategy, and partnerships such as VCE with VMware and EMC, has allowed us to set the pace for the entire industry with our annualized run rate of over $2.5 billion, and that's the UCS and the Nexus 2000 through the 5000, growing over 90% year-over-year. Innovation is at the heart of our company, more so now than ever, and you can expect more in quarters and years to come.

Order Momentum

Third, from the geographic regions and a customer segment perspective, this is a discussion across our three geographic regions. First, as the basis for your consideration, the Americas region represents about 54% of our total business. EMEA, Europe, Middle East, Africa, and Russia, represents about 29% of our business. And Asia Pacific, Japan, and China, represent about 17% of our business.

Balance was reasonable across all three geographies. The Americas grew product orders by 5% year-over-year. But to put this in perspective, if you adjust for the absence of our consumer video line of business, the growth would have been nearly 8%. EMEA grew product orders by 7% year-over-year. And Asia Pacific, Japan and China, grew by 14% year-over-year. As a reminder, in Q2 one year ago, our product book-to-bill was greater than one.

To add additional details to the regions, we saw more variance in the growth rates of the top-10 countries than we did in Q1. Japan and Canada continued on a tear at an extremely strong growth rate, each with 29% growth. UK grew 13%. Germany was down 2% and France was down 3% year-over-year. From the emerging countries, China grew 13%, Russia grew 19%, Brazil grew 15%, Mexico grew 16%, and India was down 13% year-over-year. As many of you have been reading, India has some unique challenges especially in the public sector.

Fourth, customer segments. As mentioned earlier, Cisco's total product orders grew approximately 7% year-over-year. Enterprise grew 7%, commercial grew 7%, service provider grew 12%, public sector was down 1% year-over-year. Our performance in the service provider market this quarter is proof of the power of our integrated architectural approach and the benefits of our intelligent network in helping our customers to transform their business and capitalize on new revenue opportunities. This architectural approach makes us a strategic partner to our top service provider customers globally and is what differentiates us from our competitors.

So while others talk about the decline in service provider CapEx, we are pleased with our performance and the alignment of our portfolio with our service provider customers' spending priorities.

This is our second quarter executing on our three-year plan outlined in our financial analyst conference a short time ago. We were pleased with hitting or exceeding our expectations in most cases in terms of profits, order rates, gross margins, book to bill, and the good balance across our five foundational priorities, geographic regions, and customer segments.

Of particular note, our record-breaking revenue performance and above industry growth is basically organic growth during the period.

Cash generated from operations this quarter was a very solid $3.1 billion. While our revenue performance in the quarter was based on organic growth, the competitive strength and positioning of our portfolio and solutions architectures is a testament to the quality of our acquisitions made in prior periods, and is a validation of our build, buy and partner strategy.

We have been able to integrate our new solutions into our portfolio and drive real value for our customers and opportunities for our business. We've used acquisitions as a part of our strategy for most of our history. We've been at this longer than most in the industry, and we believe we are very good at it. We understand the complexity of acquiring and successfully integrating technology companies. Over the last year we curtailed our M&A activity to a large extent as we worked hard to refocus. Now with our strategy executing well, we expect to be more active with acquisitions in the quarters in years to come, selectively adding to our portfolio with a focus on our five foundational priorities. As we have in the past, we continue to be disciplined and thoughtful in regards to price, value, and strategic fit to meet our approach to M&A.

When asked what are the key takeaways for the quarter, they are, in my opinion, first, our strategy and vision outlined in our three-year plan is taking hold and continuing to gain momentum. Second, our Q2 revenue growth and guidance for Q3 appears to be proof points in how we've been breaking away from many of our competitors. And third, our technology and business architectures, built upon integrative products, services, and software platforms are enabling our customers to innovate and to focus on new solutions and business models. At the heart of these transitions are our intelligent networks.

Our customers understand and appreciate our strategy, organization changes, our technology, and business architectures, built upon integrative products, services, and software platforms. Our ability to help them solve the most important business issues through these intelligent networks is our strategic differentiator.

There will always be challenges. At the present time, we are also watching very closely the developments in Europe and the global economy, public sector spending, India challenges, conservative IT budgets, and the results of some of our peers in the industry that have been a little bit challenging, as well as their guidance. And, of course, we'll continue to focus on our own internal challenges, which we'll do throughout the entire calendar year.

In our opinion, and Q2 reinforces our view, we are much better positioned than most of our competitors from an architectural leadership, product leadership, innovation leadership, emerging market leadership, and strength of our customers and partner relationships, combined with our current business momentum in the networking industry. Once again, we are firmly committed to driving shareholder and customer value.

Now moving on to Q3 FY12 revenue guidance. Before I get to the numbers, let me remind you, and again, that our comments include forward-looking statements, and actual results could differ materially. Also, Cisco will always be affected by major economic changes, capital spending patterns, new and existing competitors, potential issues affecting our suppliers, our ability to execute or not on our strategy, and other risk factors discussed in our SEC filing.

The guidance is based on current pipeline and our view of the business trends, based upon information we have available today and the actual results, could be above or below our guidance. Also, we all see the uncertainty in the global markets over the last several quarters and even today. It is too early to determine the effects on capital spending in calendar year 2012. Therefore, as you would expect, we will be conservative in our expectations for Q3, again, with all the appropriate caveats discussed during the conference call. With that in mind, for Q3 FY12, we expect revenue growth to be in the range of 5% to 7% on a year-over-year basis.

I will now turn the call over to Frank for more detail from a financial perspective, as well as to expand on our Q3 FY12 guidance. Frank, to you.

Financial Overview

Thank you, John. We had a very solid second quarter with record revenues of $11.5 billion, which grew 11% year-over-year. Along with a number of other strong financial metrics, we had record profitability with non-GAAP net income of $2.6 billion, up 23%

year-over-year. These results are encouraging given the ongoing market dynamics and reflect our commitment to the three-year model we shared with you last September. Which includes growing profits—as measured by earnings per share—faster than revenue.

Again, our total Q2 revenue grew 11% year-over-year.

Our total product revenue was $9.1 billion, up approximately 11% year-over-year. Let me highlight a few of the areas within our total product revenue. Switching revenue was $3.6 billion, up 8% year-over-year. Next-Generation Network or NGN Routing also grew 8% to $2.1 billion. Collaboration revenue was $1 billion, an increase of 10% year-over-year. And we saw good growth in Service Provider Video, which was up 23% to $1 billion, and in Data Center which grew 88% year-over-year to $333 million.

Services revenue was $2.4 billion, up approximately 11% year-over-year.

Our year-over-year revenue grew across all geographic regions, with increases of 9% for the Americas, 15% for EMEA, and 11% for APJC.

Our total product book-to-bill for Q2 was approximately 1.

Q2 FY12 total non-GAAP gross margin was 62.4%, which was flat quarter-over-quarter and year-over-year.

For product only, non-GAAP gross margin for the second quarter was 60.9%, a slight decrease of four tenths of a percent [0.4%] quarter-over-quarter. This change was primarily driven by strength in lower-margin Data Center and Service Provider Video products, as well as pricing, discounts and rebates—partially offset by higher volume and lower overall manufacturing cost. On a year-over-year basis, non-GAAP product gross margin was down slightly by two tenths of a percent [0.2%]. We continue to see solid momentum and positive impacts from our value engineering efforts in key product areas, which have provided stability to our gross margins over the past few quarters. Our non-GAAP service margin for the second quarter was 68%, up from 66.8% last quarter and up from 67% in Q2 FY11.

Total gross margins by geographic region were 62.7% for the Americas, 64.5% for EMEA, and 57.5% for APJC.

Non-GAAP operating expense was 34% of revenue or approximately $3.9 billion in Q2, down approximately $158 million as compared to the previous quarter. Our continued diligence in this area has allowed us to now realize—one quarter ahead of schedule—the full targeted savings of $1 billion on an annualized expense run rate, using Q4 FY11 as our base. We intend to leverage this shift in cost structure, coupled with the efficiencies in evolving our operating model, to fund future innovation and achieve value for our shareholders.

At the end of Q2, our headcount totaled 63,870, and that was up approximately 400 quarter-over-quarter, driven primarily by growth in Advanced Services and Technical Services, and strategic Engineering hiring, which was also partially offset by the remaining actions of our workforce restructuring.

Non-GAAP operating margin for the second quarter was 28.4%. To remind you, as we shared at our Financial Analyst Conference in September, we expect that the non-GAAP operating margin for our three-year model will be in the mid-20s as a percentage of revenue.

Our Q2 FY12 non-GAAP tax provision rate was 22%.

Non-GAAP net income for the second quarter was $2.6 billion, representing an increase of 23% year-over-year, and as a percentage of revenue, non-GAAP income was 22.2%. Non-GAAP earnings per share on a fully diluted basis for the second quarter were $0.47, versus $0.37 in the second quarter of fiscal year 2011, a 27% increase year-over-year.

GAAP net income for the second quarter was $2.2 billion, as compared to $1.5 billion in the second quarter of fiscal year 2011.

GAAP earnings per share on a fully diluted basis for the second quarter were $0.40 versus $0.27 in the same quarter of fiscal year 2011.

Now moving on to the Balance Sheet

The total of cash, cash equivalents and investments at quarter end was $46.7 billion, up approximately $2.4 billion from last quarter. Of this total balance, approximately $5 billion was available in the US at the end of the quarter.

Our cash flow from operations in the second quarter was approximately $3.1 billion, our strongest operating cash flow since Q4 FY10.

Our accounts receivables balance was $3.9 billion at the end of Q2.

Also at the end of Q2, Days Sales Outstanding, or DSO, was 31 days, compared to 35 days at the end of Q1 FY12 and 40 days at the end of Q2 FY11. On a year-over-year basis, the decrease in DSO was driven by continued shipment linearity, strong collections performance and service billings linearity during the quarter. Going forward, as we talked about previously, we do expect DSO to be in the range of 30 to 40 days, given our business mix, linearity and also the growth of our services business.

Total inventory at the end of the second quarter was $1.6 billion, relatively unchanged from Q1 FY12. Non-GAAP inventory turns were 10.8 this quarter, down one tenth [.01] compared to last quarter and up eight tenths [0.8] from Q2 of fiscal 2011.
Inventory purchase commitments at the end of Q2 were $4.2 billion, relatively flat

quarter-over-quarter.

Dividend

I am pleased to announce that Cisco's Board of Directors approved a 33% increase in the quarterly dividend to $0.08 per share. This dividend will be paid on April 25, 2012, to all shareholders of record as of the close of business on April 5, 2012. We remain committed to returning cash to our shareholders through both dividends and our share repurchase program.

For the second quarter, we repurchased $466 million of common stock under the stock repurchase program or 26 million shares at an average price of $17.84 per share. The remaining approved amount for stock repurchases under this program was approximately $8.2 billion as of quarter end. A dividend payment of $322 million representing $0.06 per share was declared and paid during the second quarter. And over the past four quarters, we have repurchased approximately $4.5 billion of our shares and paid quarterly dividends of approximately $1.3 billion, for a total of $5.8 billion of cash returned to shareholders.

Total deferred revenue was $12.5 billion at the end of Q2, an increase of approximately 6% compared to Q2 FY11. Deferred product revenue grew to $4 billion, or roughly 6% year-over-year, and deferred services revenue was approximately $8.5 billion, an increase of about 5% year-over-year.

Financial Guidance

Let me now provide a few comments on our outlook for the third quarter. I would like to remind you again that our comments include forward-looking statements. You should review our recent SEC filings that identify important risk factors and understand that actual results could materially differ from those contained in the forward-looking statements. The guidance is based on the current pipeline and our view of business trends based upon the information we have available today, and the actual results could be above or below our guidance.

Given the ongoing business climate as well, as the uncertain economic situation globally, regionally and with certain countries, we will continue to take a measured approach that balances business upside with potential risk. And while we are encouraged by continued demand from our customers, we are mindful of the possibility for slower IT spending in calendar 2012. In light of these factors, we encourage you to continue to model conservatively, and it's important that expectations do not get ahead of where the market is today.

The guidance we are providing is on a non-GAAP basis with reconciliation to GAAP. As John said earlier, for Q3 FY12, we expect revenue growth to be in the range of 5% to 7% on a year-over-year basis.

As we have said in the past, forecasting gross margin has always been challenging due to various factors such as the volume, product mix, cost savings, and also competitive pricing dynamics.

As we indicated last quarter, we are continuing to actively monitor and evaluate the flooding situation in Thailand. We have business continuity plans in place in order to minimize any potential impact, as we expect this situation to continue for the next several quarters. Our financial results reflect minimal negative impact from the situation, consistent with our expectations. In our guidance for the third quarter, we have factored in the minimal impact that we have estimated at this time.

For the third quarter, we anticipate non-GAAP gross margin to be approximately in the range of 61.5% to 62%.

Our non-GAAP operating margin in Q3 is expected to be in the range of 27% to 28%. Our non-GAAP tax provision rate is expected to be approximately 22% in the third quarter.

Our Q3 FY12 non-GAAP earnings per share is expected to range from $0.45 to $0.47 per share, and we anticipate our GAAP earnings in Q3 will be $0.07 to $0.10 per share lower than our non-GAAP EPS. This range includes our typical differences as well as an impact of up to $0.01 as a result of our anticipated restructuring charges.

Other than those quantified items noted above, there are no other significant differences between GAAP and our non-GAAP guidance. This guidance assumes no additional acquisitions, asset impairments, restructurings, and tax and other events, which may or may not be significant. As a reminder, Cisco will not comment on its financial guidance during the quarter unless it is done through an explicit public disclosure.

Relative to our July 2011 announcements on restructuring, we have included total non-GAAP pre-tax charges of approximately $925 million to our GAAP financial results to date. We expect the total restructuring charges to be approximately $1 billion, with the remaining charges to be incurred in the second half of fiscal year '12.

In summary, this was a very solid quarter for Cisco. Our results reflect our ongoing focus on profitable growth where profits can grow faster than revenue.
In terms of forward-looking guidance, we are executing against a long-term strategy and will continue to take it one quarter at a time, and advise you to do the same.

Overall, we are seeing good progress against our three-year financial strategy. We will continue to drive operational excellence within a very disciplined financial model, while also making the right strategic investments to fuel our business growth.

With that, let me turn the call back over to John.

Summary Comments

Frank, thank you very much. Moving forward, we'd like to provide some perspective on Q2, and our momentum going into the second half of FY12. We believe our vision, strategy, financial strengths, broad architectural approach, as well as our culture that accepts change, positions us well for growth. We have always used these market transitions to make bold and tough decisions, and then to execute in a way that further extends our leadership over our peers. For several quarters in a row, our business orders appear to be growing faster than many of our comparable industry peers.

Rob, I just want to say, a great job by you, by Chuck, by Nick, by Edzard, Chris and Paul – very, very solid. So across the board, nice job, and we're expecting it again.

We also want to continue our focus on operational excellence, driving productivity and making Cisco a simpler place to work and for our customers to do business with, at the same time organizing Cisco in a way we believe our customers will buy and our products will need to be developed, given the major market transitions that are occurring, and creating the opportunity that we discussed earlier.

Gary, again, I want to just congratulate you on the services group. I think what you've done and the team's focus on gross margins, the overall operational excellence, the customer ease of doing business, you see it across the board. So doing a super job. I want to thank you for that. What Angel's doing is really great. Well done.

Good progress, but a long way to go on the journey. In every major market transition over the last 20 years, we have historically emerged stronger and with more market share and with intense targeted focus. In our opinion, we are on our way to doing the same once again. But it is a journey, and we are still in the early stages.

You will continue to see us move aggressively, to pull away from our competitors as they adjust to these market challenges. Having already made these changes well ahead of our competition, this is also a competitive advantage for us, in our opinion.

Industry challenges and our own challenges this year caused us to make needed changes. But as we said last quarter and are repeating this quarter, we will not stop here. We will aggressively continue to change and transform and drive our Cisco entrepreneurial spirit through the combination of innovation and operational excellence. At the same time, we will maintain our laser focus on creating value for our shareholders, customers, partners, and employees. You will continue to see us a very focused, innovative, agile, aggressive, and lean Cisco moving forward.

The major transitions, from an information technology to business technology, are accelerating in our enterprise, service provider, public sector, and commercial accounts and across most industries and geographies.

Although we are only in the early stages of this transformation, our ability to use innovative solutions and intelligent networks to enable our customers to achieve their goals and their growth, productivity, cost savings, new consumption, and business models is increasing and achieving increased customer acceptance.

These are, in many ways, unusual times. On one hand, the business feels good. The demand for Cisco products and services is healthy and our relationships with our customers are the strongest they have ever been. On the other hand, there is significant uncertainty in the broader macro environment, and, as such, it is prudent for us to remain conservative in our outlook for the second half of the fiscal year.

For the remainder of FY12, you can expect us to make the required investments to advance our market leadership and drive innovation, while holding to our financial model.

I want to thank our employees, our Cisco family, for the speed and willingness to change that has positioned us to move with our customers and drive value for our shareholders. I know it has not been easy, but you all have executed and adapted to these challenges and opportunities extremely well. And that more than anything else embodies the Cisco franchise, our ability to emerge quickly, stronger, and more focused and more driven as we have in the past. Our Q1 and Q2 results certainly reflect that.

I want to thank our shareholders, employees, customers, and partners as we transition to the reinvigorated Cisco, the aggressive, focused, and simplified Cisco you have come to expect over the years.

Mel, with that, let me turn it back to you.

Closing Remarks

Thanks, John. Cisco's next quarterly conference call, which will reflect our third quarter of fiscal 2012 results will be on Wednesday, May 9, 2012 at 1:30 p.m. Pacific time.

In anticipation of our continued business and geographic growth and increased use of new business models, we are implementing enhanced planning and reporting processes. To accommodate these changes, all future quarterly earnings call will take place one week later than our historical schedule effective Q4 FY12. Our Q4 earnings call will take place on August 15th. The timing of our Q3 call will not change.

Additionally, downloadable Q2 FY12 financial statements will be available following the call, including revenue and gross margin by geography and revenue by product categories. Income statements, full GAAP to non-GAAP reconciliation information, balance sheets and cash flow statements can be found on our website in the Investor Relations section. Click on the “Financial Reporting” section of the website to access the webcast slides and these documents.

Again, I would like to remind you that in light of Regulation FD, Cisco plans to retain its long-standing policy to not comment on its financial guidance during the quarter unless it's done through an explicit public disclosure.

Please call the Investor Relations department with any follow-up questions from this call. Thank you for your participation and continued support. This concludes our call.

The prepared remarks set forth above and the related conference call may be deemed to contain forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among other things, statements regarding future events (such as statements regarding the execution on our three-year plan, results of our operational focus, ongoing innovation, our future plans and strategy, and future returns to shareholders) and the future financial performance of Cisco that involve risks and uncertainties. Readers are cautioned that these forward-looking statements are only predictions and may differ materially from actual future events or results due to a variety of factors, including: business and economic conditions and growth trends in the networking industry, our customer markets and various geographic regions; global economic conditions and uncertainties in the geopolitical environment; overall information technology spending; the growth and evolution of the Internet and levels of capital spending on Internet-based systems; variations in customer demand for products and services, including sales to the service provider market and other customer markets; the return on our investments in certain priorities, including our foundational priorities, and in certain geographical locations; the timing of orders and manufacturing and customer lead times; changes in customer order patterns or customer mix; insufficient, excess or obsolete inventory; variability of component costs; variations in sales channels, product costs or mix of products sold; our ability to successfully acquire businesses and technologies and to successfully integrate and operate these acquired businesses and technologies; increased competition in our product and service markets, including the data center; dependence on the introduction and market acceptance of new product offerings and standards; rapid technological and market change; manufacturing and sourcing risks; product defects and returns; litigation involving patents, intellectual property, antitrust, shareholder and other matters, and governmental investigations; natural catastrophic events; a pandemic or epidemic; our ability to achieve the benefits anticipated from our investments in sales, engineering, service, marketing and manufacturing activities; our ability to recruit and retain key personnel; our ability to manage financial risk, and to manage expenses during economic downturns; risks related to the global nature of our operations, including our operations in emerging markets; currency fluctuations and other international factors; changes in provision for income taxes, including changes in tax laws and regulations or adverse outcomes resulting from examinations of our income tax returns; potential volatility in operating results; and other factors listed in Cisco's most recent reports on Form 10-K and 10-Q filed on September 14, 2011 and November 22, 2011, respectively . The financial information contained in the prepared remarks and the related conference call should be read in conjunction with the consolidated financial statements and notes thereto included in Cisco's most recent reports on Form 10-K and 10-Q, as each may be amended from time to time. Cisco's results of operations for the three and six months ended January 28, 2012 are not necessarily indicative of Cisco's operating results for any future periods. Any projections in the prepared remarks and the related conference call are based on limited information currently available to Cisco, which is subject to change. Although any such projections and the factors influencing them will likely change, Cisco will not necessarily update the information, since Cisco will only provide guidance at certain points during the year. Such information speaks only as of the date of the prepared remarks and the related conference call.