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 FY08 Financial Results Conference Call
Wednesday, February 6, 2008
1:30pm PT

Introduction

Welcome to Cisco Systems second quarter fiscal year 2008 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 Ms. Blair Christie, Senior Vice President of Corporate Communications for Cisco Systems. Ma'am, you may begin.

Thank you, Kim, and good afternoon, everyone. Welcome to our 72nd quarterly conference call.

I'm Blair Christie, and I'm joined by John Chambers, our Chairman and CEO; Dennis Powell, Chief Financial Officer; Rick Justice, Executive Vice President of Worldwide Operations and Business Development; Frank Calderoni, Senior Vice President of Customer Solutions Finance and our next Chief Financial Officer, effective February 15th; as well as Ned Hooper, Senior Vice President of Corporate Business Development and Consumer and Small Business; Pankaj Patel, Senior Vice President and General Manager of our Service Provider Technology Group; and Jim McDonald, Chief Executive Officer of Scientific-Atlanta.

The Q2 fiscal year 2008 press release is on Full National Market Wire and the European Financial and Technology Wire, and on the Cisco website at www.Cisco.com.

I would like to remind you that we have a corresponding webcast with slides. In those slides, you will find the financial information we cover during this conference call, as well as additional financial metrics and analysis that you might find helpful.

We have posted full GAAP to non-GAAP reconciliation information along with our financial statements on our website in the Investor Relations section. Additionally, downloadable Q2 financial statements will be available following the call, including revenue segment by product and geography. Just click on the Financial section of the website to access the webcast slides and these documents.

A replay of this call will be available via telephone at 866-357-4205, or 203-369-0122, for international callers, and is also available from February 6th through April 18th on Cisco's Investor Relations website, www.cisco.com/go/investors.

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results.

The financial results in the press release are unaudited.

In 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 annual report on Form 10-K and 10-Q 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. And I would now like to turn it over to John for his commentary on the quarter. John?

Opening Remarks

Thank you, Blair. During the opening comments of the conference call, I will focus on what I view to be the key takeaways for Q2, an update on why we are comfortable with our long-term growth projections of 12 to 17%, and our revenue guidance for the next quarter, with the appropriate caveats.

The opening comments will also include discussions on what we believe is driving our current growth, as well as what we think will be the key factors that we expect should allow us to continue to maintain a solid long-term growth rate over the next three to five years.

Dennis will follow with additional detail on Q2. The third section of the call will focus on a more detailed discussion of business momentum and strategy on a geographic, product, and customer segment basis. Frank will then provide additional financial parameters around our guidance for Q3. I will then wrap it up with some comments in terms of Cisco's momentum going into Q3, and finally our Q&A session.

Now on to the discussion of Q2. This quarter was another solid quarter, with good balanced results from a product, geographic, and customer segment perspective.

To put these record results in perspective, I will summarize the quarterly highlights. First, from a key financial perspective; second, from a product and services perspective; third, from a geographic point of view; and fourth, by customer segment.

The key financial highlights for Q2 include the following.

Total record revenue of approximately $9.8 billion, a 16.5% year-over-year increase, which was slightly above our guidance of approximately 16% provided in the Q1 conference call. We are pleased with both the growth on the top line and bottom line.

Order growth was good, with product book-to-bill of approximately 1. We will provide additional details about how the order growth occurred throughout the quarter, later in the discussion.

Non-GAAP net income was $2.4 billion, an increase year-over-year of approximately 14%. GAAP net income was $2.1 billion, representing a 7% increase year-over-year.

Non-GAAP earnings per share were $0.38 and GAAP earnings per share were $0.33, which were increases of 15% and 6% respectively, year-over-year.

Cash generated from operations was $2.4 billion. We repurchased $4 billion of common stock, and we exited the quarter with $22.7 billion in cash, cash equivalents, and investments, as compared to Q1 fiscal year '08 of $24.7 billion.

However, if there are two key takeaways from our Q2 results, the first would again be the continued unique balance in terms of our business models, which are implemented from both a technology architecture and a business architecture perspective. This balance is illustrated across 20 major product families, four key customer segments and four major geographies.

The second takeaway is built around market transitions, which is a core competency of Cisco. And then to develop our vision for how these market transitions play out for the industry and position Cisco in terms of our sustainable differentiation in industry leadership.

The second takeaway, which is just beginning in my opinion, will drive our growth and differentiate us from our peers over the next five years-plus, will be phase two of the internet. We expect the second phase will be driven by collaboration enabled by network Web 2.0 technologies.

In the last several quarters, we believe we have achieved the clear number one position, from both a thought leadership and implementation, and we intend to expand upon this position of leadership.

This collaboration, enabled by networked Web 2.0 technologies will in our opinion, transform business models with a speed we have not seen in over a decade. It is our intent to not only lead in terms of thought leadership when applying these technologies, but to be the best example of how this can drive productivity and a number of cross-functional opportunities a company can focus on at any point in time. We will discuss this also in greater detail later in the call.

Whether it is the Service Providers' potential increase in the network loads driven by Web 2.0 technologies or the Commercial Enterprise customers who see the next wave of productivity occurring through these network technologies, we are seeing increased acceptance of both Cisco's business and technology architecture strategy, and this dramatically differentiates us versus our industry peers.

In the last several months I've had the opportunity to travel throughout Asia Pacific, North America and the Emerging Markets. Whether it is with the government leaders in developed and Emerging Markets, or the Service Provider or Enterprise decision makers, our thought leadership, technology architecture and our ability to help them achieve their business and governmental goals is increasingly understood at all levels.

We saw this in November during our visits to India and China, and most recently at the World Economic Forum, where we met with almost a dozen heads of state or key government leaders. We also saw the unique opportunity Cisco can play during our recent trip throughout the Middle East Gulf States, where order growth opportunities remain very strong.

One example of this architecture and thought leadership would be in Saudi Arabia, where two weeks ago I spent three days meeting with various business and government leaders. Whether it was on the topic of their new economic cities, Cisco's role as their infrastructure partner, or Cisco's role in assisting in their global competitiveness, our vision, strategy and execution is playing out as we envisioned.

And as we become a trusted advisor and implementation engine for both the business and government leaders, we can normally expect to get the growth that accompanies this leadership position. Saudi Arabia is an example of this in this last quarter, where we achieved 70% order growth rates, year-over-year.

Revenue growth from our key products, including Services, was strong across almost all categories. In terms of our three broad product categories, Routing revenue grew year-over-year by 18%, led by our high-end Routing products, which grew in the high 20s year-over-year. Switching revenue grew year-over-year by 11%. And the total of our Advanced Technologies' revenue grew year-over-year by approximately 25%.

Again, in considering our ability to move into new markets and to achieve both growth and profitability, our total Advanced Technologies' revenue was more than 20% greater than the revenue from our Routing products. This again speaks to Cisco's balanced product portfolio and to our constant evolution of moving into new markets and product adjacencies.

Although we will discuss growth in a number of products in more detail later in the call, I want to provide a quick snapshot from a revenue perspective of five of our product highlights in Q2.

High-end Routing was very strong and the CRS-1 continued to be our best example of a flagship leadership product, with revenue growth of approximately 60% year-over-year. In the Datacenter we had a very strong revenue growth of approximately 27% for our MDS 9000 product family.

Our Catalyst 6000 high-end switching line had a very solid quarter of revenue growth of approximately 20%. And while on the subject, I would like to call your attention to the very successful launch of our Nexus 7000 Series data center platform, which is the first in a new line of Switching products optimized for high-density 10-gigabit Ethernet in the Datacenter, and the expansion of our Catalyst Switch family on January 28th.

Analysts are calling the Nexus 7000 one of the best products ever to emerge from Cisco, purpose built for the very high-end, the data center, in terms of software architecture with a focus on high availability, capacity, performance and security.

Unified Communications, including products from our WebEx acquisition, had revenue growth of approximately 60% year-over-year.

We continue to achieve good product balance, both in terms of breadth and depth of our product portfolio. We now have 10 product families with orders and revenue run rates above $1 billion. And many of them continue to gain share in their respective product categories.

To add additional information regarding the balance of our revenue across our product lines and potential future momentum, 13 of our top 20 product families had year-over-year revenue growth run rates for Q2 of 15% or better.

Although the competition remains robust, we believe we are maintaining leadership versus many of our major competitors in many product families. And we also believe we are getting a larger share of our customers' total spend of communications and IT. As we have discussed in prior conference calls, our services are not a standalone product area, but rather they are a delivery vehicle through which we earn our customers' trust and satisfaction, by enabling their technology and business goals.

Our services revenue represents approximately 16% of our total revenue. In Q2, our revenues for services grew year-over-year approximately 18%. This is obviously a strong revenue growth rate for a $6 billion run-rate business, with non-GAAP gross margins of approximately 63.5%.

Also, our services-led approach to sales continues to gain traction with our customers. There is usually a direct correlation between the amount of services our customers buy from Cisco and the growth rates of our core products. In other words, the more services customers purchase, usually the higher the customer satisfaction and the higher the growth rates in our product orders. An example of this would be our strategy in the Emerging Markets.

The geographic and customer segments discussed will be primarily in terms of orders, as this is how we run our business. From a geographic perspective, order momentum was solid and balance was reasonably good across our four large theaters during Q2, with the year-over-year order growth rates ranging from 8% to mid-20s.

Emerging Markets, which tend to have large orders and be lumpy in terms of when the orders occur, grew 24% in terms of product order growth rate. Asia Pacific continued to be very solid and grew approximately 23%, followed by the US, with growth of approximately 12%.

Europe grew year-over-year approximately 8% in Q2. Additional detail about Europe that may be of interest, is that our combined orders for Commercial and Enterprise -- that does not include Public Sector, grew in the low-20s. The Service Provider business, after a very strong growth in the mid-20s in Q1, was actually down approximately 6% year-over-year in Q2. Public Sector in Europe was flat year-over-year in Q2.

From a customer segment perspective, we again saw solid balance across our Commercial markets, Service Provider, and Enterprise segments. The Global Commercial market segment remained our most steady segment, with order growth of approximately 20% year-over-year in Q2.

With the exception of Europe, the core Global Service Provider business remains strong. Orders from a Service Provider perspective, excluding Scientific Atlanta, grew approximately 20% year-over-year.

US Service Provider business continued with growth in the high 20s, again excluding Scientific Atlanta. And this is in terms of orders. And marks the 12th quarter in a row that they had order growth rate above 20% year-over-year. As a reminder, Scientific Atlanta saw significant growth last year, due in part to the 707 Security requirements. Those were very tough comps, Jim, year-over-year. Although, revenue growth for the quarter was 20%, if I remember right.

Video continues to drive Service Provider network demand and is potentially the killer application for loading and bringing value to the network. We continue to be very pleased with accelerating momentum from video applications. Consumer video and broadband build-outs are driving much of the Service Provider investment.

From an Enterprise and Commercial perspective, we expect that the global video implementation, such as IPTV, TelePresence, Unified Communications, Physical Security and other video applications, will drive increasing future network loads, and therefore, also require upgrades to existing networks.

Using Cisco as an aggressive example, as we begin to implement Unified Communications, TelePresence and other video applications across our entire company, we expect the future growth of our network loads could be closer to 400% annually over the next several years.

In the last 12 months we have conducted over 68,000 meetings via TelePresence and have only 174 units installed. I think all of us understand the opportunity this represents for Cisco and our Service Providers partners if networks evolve the way we hope. Think of the possibilities if companies begin to implement 1,000-plus TelePresence units and eventually move into employees homes for both business and entertainment purposes with this type of technology.

One of the best indications of the industry’s anticipated loads on networks is our order growth rate in high-end routers. While we had very strong order growth rate in high-end routers during the first three quarters of fiscal year 2007, which averaged approximately 20% year-over-year, we are now experiencing growth rates in Q4 '07, again in Q1 '08, and now in Q2 '08, of approximately 30% year-over-year or better.

Q2 year-over-year order growth rates were approximately, as I said, 30% in our Q2, and this was led by the CRS-1, with year-over-year order growth rates over 100%.

Global Enterprise business, which includes Public Sector, was solid. Our Enterprise customer segment, on a global basis, grew approximately 11% year-over-year in terms of orders.

There is one major area that I would like to update you on, on every conference call, because of its importance to both Cisco's future growth and the industry as a whole. This is built around our view of how the industry will evolve, both from intelligent networks' role, as well as the next generation of productivity, business and governmental models built around network technology capabilities.

We believe that as the network becomes the platform and we approach this from both a business and a technology architecture perspective that the next frontier for growth will be around collaboration enabled by the network tools often defined as Web 2.0.

Every quarter over the last year, Cisco has expanded our position in terms of thought leadership and how we use these capabilities internally. We believe that we are the example in business for what's possible when an organization adopts a collaborative approach enabled by network Web 2.0 technologies.

We consistently hear this from both our Enterprise and Service Provider customers, as well as from key industry analysts. I cannot overemphasize the importance of leading in this market transition from products to process for internal adoption and utilization, and what we believe this leadership position means for Cisco's future.

Our ability to understand market transitions, whether technology or business model based, has been one of the key contributing factors to our success. We have seen dramatic growth from our investments as market transitions have occurred, whether it is in the Advanced Technologies five years ago, Emerging countries two years ago, or our globalization center in India over the last year.

At the beginning of this fiscal year, we shared with you our aggressive implementation of new technologies and new business models based on collaboration. Instead of doing one or two priorities a year, as we did very successfully in our traditional command and control approach, we can now focus on 20 priorities, with a collaborative structure and replicable process driven by our Councils and Boards.

These smaller teams are moving faster than we could in the command and control structure and are enabling our ability to move into new market adjacencies with a speed and effectiveness that we would not have been able to do before.

When you think about our long-term growth opportunities, there is no other important market transition than this revolutionary business model change. And we have been very pleased with the progress and results the first half of the year. This is one of the key reasons that in spite of what happens with macroeconomics and other issues in the short-term, we remain comfortable with our long-term growth projections.

Key takeaway is the potential business model changes that are occurring at Cisco, which enables our ability to move into new market adjacencies and innovate with a speed and effectiveness that we would not have been able to do before, positions us to compete uniquely during these market transitions.

Cisco will always be affected by major economic changes, capital spending patterns, new and existing competitors, and our ability to execute or not on our strategy and other factors, as we discussed in our financial reports.

For purposes of our long-range guidance, as well as our quarterly guidance, we are also assuming that our vision of how the industry and the market will evolve will be accurate and we will effectively execute on that vision. Therefore, we continue to believe, with the appropriate caveats, our long-term guidance should be in the 12 to 17% range year-over-year.

While at the risk of stating the obvious, and as we have said repeatedly in prior conference calls, and we'll continue to say in our future conference calls, there may be times when our revenue growth is above the 12 to 17% range and there will definitely be times when our growth is below this range.

While we continue to be extremely comfortable with our vision and differentiated strategy, as a value that intelligent networks will bring across all of our customer segments and geographies, we also see the economic challenges that the US is experiencing. Our customers in many of the Emerging countries, especially in India and China and the Middle East, remain optimistic about their business momentum. However, we are seeing our US and European customers become increasingly cautious. This was my key takeaway from the World Economic Forum two weeks ago.

While we were pleased with our revenue growth slightly above 16% in Q2, our product order growth in Q2 was in the low teens. The second quarter was unusual by month in terms of these order growth rates. December was strong, with year-over-year growth in terms of orders in the high teens. Our January growth was less than we expected, with order growth rates of approximately 10%.

We are all seeing the challenges, the global stock markets and the US stock markets had, including a very challenging January, as well as the steady stream of challenging economic and confidence data over the last month. These and other events, along with our own order growth in January, combined with the economic, business and consumer confidence changes, make forecasting next quarter's business momentum extremely challenging.

In traditional Cisco fashion, our approach to financials will be transparent and conservative in our projections, to the best of our abilities. Again, let me repeat, with our usual caveats discussed earlier, that we continue to believe in our long-term growth guidance of 12 to 17%.

While it is always possible that January's order growth rates were an aberration, given the uncertainties of the global financial markets and the cautiousness we are seeing from some of our customers and our peers, we believe that the proper approach to guidance, with our usual caveats at this point in time is to assume that January's order growth rates may continue over the next several months.

One of Cisco's core competencies is our ability to focus on market transitions, understand their long-term implications and opportunities, as well as to position Cisco to gain strategic advantage during these transitions. There are three key basic rules we follow during periods of potential economic challenge.

The first is to review whether or not your strategy is working well going into the time period or did you contribute to the potential challenges? Secondly, how long do you think it will last and how challenging do you think it will be? And third is to position the organization for the upturn. We have done this repeatedly through the years, in 1993, 1997, 2001, 2003, and in each of those scenarios we gained both market share and profit share. And as a result, we were better positioned coming out of the transitions versus our peers.

In terms of the current economic transition that may be going on, we believe that our strategy and the critical role the network plays in enabling all forms of communication and IT is right on target.

Secondly, with all the appropriate caveats, our best estimate is that this is a relatively short-term challenge going forward. Cisco will use these bumps as a chance to gain market share and to be aggressive about moving into new market adjacencies. Whether we will return to our longer-term growth target of 12 to 17% in one or two quarters or a little longer is yet to be determined.

Therefore, our revenue guidance for Q3 fiscal year 2008, including our usual caveats as discussed earlier and in our financial reports, is for revenue growth of approximately 10% year-over-year. For those areas that we can control or influence, I'm very optimistic of our ability to achieve the desired business results, both in the short-term and in the long-term.

For areas out of our control or influence, including the broader macroeconomic environment, we will share with you what we are seeing to the best of our ability, just as we have done in the past during our quarterly conference calls.

In summary, we believe that we are very well positioned in the industry, from a vision differentiated strategy and execution perspective. As I stated earlier, we believe we are entering the next phase of the internet, as growth and productivity will center on collaboration enabled by network Web 2.0 technologies.

We will do our best to provide the product architectures and the expertise to help in the implementation of these collaborative capabilities from a technology and a business perspective. We will also share with our customers how we have done this internally.

In short, we are going to attempt to execute a strategy over the next decade that is similar to what we did in the early '90s, and as we said before, it powered growth for the next decade. Except with the obvious difference of being a company that is now approaching 40 billion in sales and over 64,000 employees focused on this opportunity.

At this time, I'd like to turn it over to Dennis for further discussion of the Q2 financial highlights. Dennis, to you.

Financial Overview

Thanks, John. We were very pleased with Cisco's solid results this quarter.

Total revenue for the second quarter was $9.8 billion, an increase of 16.5% year-over-year, which is above our guidance. Routing revenue continued to be strong at $2 billion, up 18% year-over-year, due primarily to continued growth in our high-end router portfolio at 27% year-over-year, with particular strength in the CRS-1, 7600, and the GSR families.

Switching revenue was $3.3 billion, an increase of 11% year-over-year, with balanced growth in both modular and fixed portfolios. Advanced technologies revenue totaled $2.4 billion, representing an increase of 25% year-over-year, with strong performance in Unified Communications, Storage and Video Systems. Other product revenues totaled $523 million, an increase of 9% year-over-year.

Total Service revenue was $1.6 billion, up approximately 18% year-over-year, as a result of solid growth across all geographies. We are particularly pleased with growth in Advanced Services of 37%.

Total revenue growth by geography grew in a range from 8% year-over-year in European markets and Japan, to a high of 53% in Emerging Markets. Emerging Markets revenue growth was higher than the order growth that John had reported on earlier, due to increased shipments and recognition of previously deferred revenue.

Q2 total non-GAAP gross margin was 65.5%, approximately flat from last quarter and up 0.7 points year-over-year. For product only, non-GAAP gross margin for the second quarter was 65.9%, up from 65.7% last quarter and from 64.8% in Q2 FY '07.

The favorability was driven primarily by continued cost savings, partially offset by pricing in discounts. Our non-GAAP Service margins for the second quarter were 63.5%, down from 65.2% last quarter and 64.4% in Q2 FY '07.

Service margins will typically experience some variability over time, due to various factors, such as the change in mix between Technical Support Services and Advanced Services, as well as the timing of Support contract initiations and renewals.

Total gross margin by geography ranged from 62% for Emerging Markets, to 70% in Japan.

As expected, non-GAAP operating expenses as a percentage of revenue were approximately 36% in Q2 FY '08, up from 34.6% in Q2 FY '07. The Q2 year-over-year foreign exchange impact on operating expenses was $93 million, which adds approximately 1% to this ratio. Our Q2 FY '08 non-GAAP tax provision was 24%.

Non-GAAP net income for the second quarter of fiscal 2008 was $2.4 billion, compared to $2.1 billion in the second quarter of fiscal year 2007, representing a 14% increase year-over-year. Non-GAAP earnings per share on a fully diluted basis for the second quarter were $0.38, up from $0.33 in the second quarter of fiscal year 2007, a 15% increase year-over-year.

GAAP net income for the second quarter was $2.1 billion, as compared to $1.9 billion in the second quarter of fiscal year 2007. And GAAP earnings per share on a fully diluted basis for the second quarter were $0.33, up from $0.31 in the same quarter of fiscal year 2007.

Moving on to the balance sheet

The total of cash, cash equivalents and investments at the end of Q2 was $22.7 billion, down $2 billion from Q1. During Q2, we generated $2.4 billion in cash flow from operations, as well as $626 million in proceeds from stock option exercises and employee stock purchases. We repurchased $4 billion of common stock, for 139 million shares of our stock, at an average price of $28.67.

Moving on to accounts receivable

We ended the quarter at $4.2 billion, up from $3.4 billion at the end of Q1. At the end of Q2 FY '08, days sales outstanding, or DSO, was 39 days, up from 33 days in Q1. The increase was driven primarily by several large multiyear service agreements that were signed in January.

Total inventory for Q2 was $1.3 billion, approximately the same level as Q1 FY '08. Non-GAAP inventory turns improved from 10.0 last quarter to 10.5 this quarter. Our inventory purchase commitments at the end of Q2 were $2.7 billion, up 10% from the end of Q1.

Deferred revenue was $8 billion in Q2 FY'08, an increase of $876 million from Q1 FY '08, and $1.9 billion from Q2 FY '07. Deferred product revenue was $2.7 billion, up $235 million from last quarter, and deferred service revenue was $5.3 billion, up $641 million from last quarter, due to the addition of several large Service contracts that I referred to before.

At the end of Q2, our head count totaled 64,087, a net increase of approximately 1,000 from Q1 FY '08. Our head count increases were primarily the result of Cisco hires in Sales, Services and Engineering.

Summary

In conclusion, I am pleased with our solid financial performance for the second quarter of the fiscal year, including strong top-line growth, as well as maintaining margins, operating expenses and operating income all within our target range.

Cisco's financial strength and stability gives us the ability to capitalize on and take advantage of market transitions. And we will continue to invest in our diversified technology portfolio, as well as new and adjacent markets that drive future growth and help achieve our long-term growth target of 12 to 17%.

As we announced back in Q4, I plan to retire on February 15th. I just want to take a moment to thank everyone participating in today's call for the valuable working relationships that we've developed during my career at Cisco. Your insight and feedback over the years has made this job the most fulfilling of my career. Thank you.

So now with another strong quarter, a strong balance sheet, outstanding growth opportunities and my continued confidence in Cisco's ability to drive long-term shareholder value, I hand over the CFO responsibilities to Frank Calderoni, who will take you through our detailed guidance for Q3, after John's additional commentary on the quarter. John?

Geographic, Customer Segment, Product and Strategy Review

Dennis, thank you so very much in many, many ways. I'll make a few personal comments later in the call, thanking you appropriately for your many years of leadership here. You've done a great job.

Thank you.

In this section of the call, we will cover our geographies, customer segments and product reviews for Q2 in more detail. The products review will be in revenue growth terms, while the geographic and customer segments will be discussed in terms of orders, unless otherwise indicated.

Geographic

First we will provide additional details from a geographic and a customer segment point of view. There will be a number of positives from our four largest theaters and customer segments.

From a US perspective, order growth was approximately 12% year-over-year. We had another very solid quarter in the Service Provider business in the US. Our traditional core Service Provider business, not including Scientific Atlanta, grew in the high 20s year-over-year. Again, this is the 12th straight quarter that this business has grown year-over-year in excess of 20%.

Our Scientific Atlanta portion of our US business had strong revenue growth of approximately 20%. Orders dropped by approximately 5% when compared to last year's strong quarter, due in part to the 707 Security requirements introduced in July of 2007.

The combined US Service Provider orders, including both our traditional core products and Scientific Atlanta's products, grew approximately 13% year-over-year.

The Commercial market continued its solid growth of approximately 20%, including our WebEx and IronPort acquisitions. Our Enterprise business, which includes Federal, grew 9% in Q2. Our Federal business, after a very strong Q1, was relatively flat in Q2 year-over-year. The remainder of the Enterprise business grew year-over-year approximately 11%.

As a reminder, this Enterprise business, not including Federal, was down slightly year-over-year in Q1.

Following last quarter's conference call, several of you asked for additional information regarding our large Global Enterprise accounts and to expand our discussion beyond what they just installed only in the US. As a reminder, in our Q1 call we talked about the challenges and lack of growth in our very largest accounts in the US.

At this time, based on your feedback, I would like to give you additional information on these trends, both in terms of US Enterprise business and the rest of the world for these large multinationals.

During last quarter's conference call we shared with you that US domestic orders were down year-over-year. However, for the rest of the world, orders were actually up in the mid-teens year-over-year for these accounts. However in Q2, US domestic orders from our largest Enterprise accounts grew in the mid-teens and the rest of the world was above 40% year-over-year growth.

The mix of our business from large US Enterprise accounts has moved from over 50% of their total business for Cisco occurring in the US two years ago. To today where approximately 60% other business occurs outside the US. I hope this provides additional detail that answers some of your questions from the last call.

The Asia Pacific theater continues to be very solid in terms of its momentum with year-over-year growth of approximately 23%. There was good balance across the Enterprise, Service Provider and Commercial markets, ranging from low 20s to high 20s year-over-year.

As we shared in last quarter's conference call, we like our expanding vision and strategy and commitments in both China and India. We were therefore very pleased with the strength of orders in Q2 in both of these countries, with India growing year-over-year with an extremely strong 50% growth in Q2, and China growing approximately 30% year-over-year in Q2. We continue to expect these two countries businesses will fluctuate quarter-to-quarter, due to the timing of very large orders, from which we obviously benefited in Q2.

Our strategy and focus on our Globalization Center, led by Wim Elfrink's team based in India, is working extremely well. Our Globalization Center concept and partnership with the Indian based large consulting groups is working at the high end of our expectations, both in India and throughout the Emerging Markets.

Our growth in China generally has been strong over the last several quarters, as we made the decision to dramatically expand our commitment and our goals in China over the next five years.

We believe we are uniquely positioned with both business and government leaders to create a major win-win scenario across multiple segments of their economy. Again, the feedback from our business leaders from China and India at the World Economic Forum two weeks ago, was that they expect their economic growth to continue to be strong and for Cisco to play a strong partnering role in their growth.

Moving on to Emerging Markets. Product order growth rate in Q2 was approximately 24% year-over-year. This business by definition will be based in part on large orders and therefore, both growth rates will vary from quarter-to-quarter. Balance was solid we saw across all four Emerging Market operations, ranging from 22 to 32% year-over-year.

Moving on to Europe. Our European operations had strong order growth in Q2 in the Enterprise, not including Public Sector and Commercial markets, as we said earlier with a combined growth of over 20% year-over-year. However, the Service Provider business in Europe, after a very strong Q1 with growth in the mid-20s, actually experienced negative growth in the mid-single-digits in Q2. Therefore in total, our European business grew approximately 8% year-over-year.

Products

Moving on to Products. As we discussed earlier, our Products business was well balanced. We will attempt to give you more details regarding this balance in the following discussion, which will be covered in terms of revenue and will include our acquisitions.

Total revenue growth balance was once again very good in Routing, which grew 18% year-over-year. Switching grew approximately 11% and total Advanced Technologies grew 25%. Our first wave of five Advanced Technologies in Q2, had year-over-year revenue growth of approximately 22% and in total is approximately $7 billion in terms of run rate from a revenue perspective. And that is just the first wave.

Unified Communication, including the addition of WebEx, continued to lead the way with revenue growth of approximately 60%. And just for a data point, Unified Communication without WebEx was 30% year-over-year growth.

Storage was up approximately 30%. Wireless was up approximately 10%. And the Network Home was down approximately 5%, while Security growth was in the 12% positive year-over-year level.

Our second wave of Advanced Technologies that includes video systems, application networking systems, etc., is now approaching $2.7 billion run rate and grew 31% year-over-year from a revenue perspective.

From a Product perspective, we are not aware of any other company in the IT and communications industry that is even close to these types of growth numbers and market leadership across such a broad array of products.

Vision, Strategy, Execution

In summary, our vision of how the industry is going to evolve appears to be playing out very much as we expected. We believe that our differentiated strategy is also achieving the benefits to both Cisco and our customers that we thought were possible.

And finally, our execution is on target in terms of results, as measured by customer partnership perspective, market share and share of our customers' total communications and IT expenditures, as the network becomes the platform for delivering these capabilities.

At this point in the call I'd like to take an opportunity and time to thank you, Dennis, for the last five years of service, integrity and results that we've achieved together here at Cisco, under your leadership as CFO. Dennis you've done a great job and you've been a very good friend and business partner. Thank you very much for the job done well and we will truly miss you.

Thank you John.

However, you've done a great job also, in classical Cisco fashion, with a smooth transition to Frank. And so Frank, it's with a great deal of pleasure that I now turn the call over to you for a more detailed discussion of financials regarding Q3 guidance. Frank?

Financial Guidance

Thank you, John. Let me 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 we are providing is on a non-GAAP basis with reconciliation to GAAP.

We anticipate total revenue growth for the third quarter to be 10%, plus or minus 1% year-over-year. The unusual business momentum we experienced in January, when combined with the uncertain economic, business and consumer confidence outlook, makes forecasting this next quarter's business momentum extremely challenging.

With that in mind, we believe it is prudent and conservative to provide guidance for Q3 only. Which means although we believe it is probable that we will be in the lower end of the 13 to 16% revenue growth range for FY '08, we are not providing Q4 guidance at this time.

As we have said in the past, forecasting gross margin has always been challenging due to various factors such as volume, product mix, variable component costs, customer and channel mix and competitive pricing pressures.

That being said, we believe total gross margin in Q3 will be approximately 65%. We believe Q3 operating expenses will be in the range of 37% of revenue. We expect interest and other income to be approximately $200 million in the third quarter. Our tax provision rate for Q3 is expected to be approximately 24%.

While we expect to continue our share repurchase program, it is difficult to predict the exact weighted average shares outstanding. We are modeling share count to be down approximately 50 to 100 million in weighted average shares outstanding for EPS purposes. In this estimate of share count, we are not taking into consideration any further change in stock price that could occur in the third quarter of fiscal year '08.

As a point of reference, a $1.00 increase in the average stock price would increase the calculated shares outstanding for purposes of determining earnings per share, by approximately 15 million shares.

Regarding cash flow from operations, we would expect to generate $700 to $900 million per month at these revenue levels. For our Q3 fiscal year '08 GAAP earnings, we anticipate that Q3 GAAP EPS will be $0.04 to $0.06 per share lower than non-GAAP EPS, primarily due to acquisition-related charges and stock option expense. Please see the slides that accompany this webcast for further details.

Other than those items noted above, there are no other significant differences between GAAP and our non-GAAP guidance. This guidance assumes no additional acquisitions, asset impairments, restructuring, and tax or other events which may or may not be significant.

I will now turn the call back over to John.

Summary

Frank, thank you very much. The following is a summary of my views of Cisco's momentum and opportunities entering the third quarter of fiscal year 2008. In the areas that Cisco can control or influence, our momentum continues to be strong. Balance continues to be reasonably good across our Geographies, Products, Services and Customer segments.

We clearly continue to see the same things each of you sees, in terms of opportunities and concerns in the US market and concerns about expanding to other geographies. If the market does continue to slow, we believe this will not dramatically change our long-term opportunities with our vision of how the industry will evolve and our differentiated strategy.

In fact, it is our intent to expand our market share during these corrections, as we have done in the past. As we have done again and again, we think we can gain more market share during the challenging times and estimate we can do that while maintaining our guidance on gross margin.

From a geographic perspective we continue to be very optimistic about the majority of our global economies outside the US. Based upon what our customers are telling us and our balanced strength in these countries across Customer segments, Product families and value-added services. We will continue to monitor closely any spread of US challenges to other geographies, especially Europe.

From a US perspective, the Service Provider market continues to be the area where we are most comfortable. While we believe that these comparisons to prior quarters for Scientific Atlanta growth will be challenging to the next quarter or two, because of last year's very strong growth, enabled in part by the Security requirements. Our core Service Provider business projections continue to be strong.

Our product roadmaps for both current and future products also looks strong for the Service Provider segment.

As we discussed in prior conference calls, the strategic relevance of Cisco is increasing to our Service Provider customers and has the potential to evolve the same way our Enterprise leadership evolved over the last 15 years, with the associated business benefits to both Cisco and our Service Provider customers.

We are continuing to see from many of the world's top Service Providers, the willingness to partner with Cisco on both a technology architecture and a business strategy perspective. This is an opportunity that many would not have anticipated two years ago, and one that is clearly playing out in line with our vision and differentiated strategy, the way that had hoped.

Commercial market remains solid and well balanced on a Global basis. We are continuing to expand our Products, Services and Distribution capability to this very important segment. In our opinion, there are many things that are exciting about the second phase of the internet, as it enables collaboration and social networking to network Web 2.0 technologies.

But at the top of the list is both the speed and effectiveness with which these challenges can be implemented across all customer segments. Again, if we are right about the value it brings to both business and individuals, this is at the top of the first inning in a nine-inning game in terms of its broad business acceptance and associated benefits.

We clearly intend to lead all companies in our implementation, organizational evolution and associated productivity of these new collaborative technologies. A competitive advantage of how we ourselves will become the best example for what this means to a company's future. This type of collaboration, enabled by the network, will allow Cisco, instead of doing one or two major priorities a year that the senior management team aggressively led in a command and control style, to target 20 for this fiscal year in a collaborative style.

We are reviewing the progress of these 20 corporate initiatives on a regular basis, and I can not be more pleased with both the speed with which we are moving, as well as the strategy and execution that each of these groups are achieving at this point in time. With these early successes in mind, you will probably see us expand the number of these initiatives over the next several quarters.

Our business and technology architectural strategy in the Emerging Markets is working extremely well. Barring some major economic or political surprises across many of these emerging countries, I would expect this theater, on average, to have the potential to grow more than twice the average growth rate of the other theaters if we execute effectively.

Our balanced product momentum across our core technologies and Advanced Technologies continues to be solid. But again, it is the loosely and then tightly coupled product strategies for these technologies that dramatically differentiates Cisco from our peers.

Our pipeline of potential new core Routing and Switching products looks to be very good. Our continued evolution of our first wave of Advanced Technologies and the emergence of a second wave of Advanced Technologies is evolving as we expected. At the same time, we are beginning to plan a potential third wave with our next generation of early stage emerging technologies.

In summary, our product pipeline is in excellent shape and really looks exciting. Having said that, obviously the proof continues to be in the results. Again, on a Global and US basis, we see the same challenges and uncertainties from an economic, political and capital spending concern that many of you continue to witness.

At the risk of stating the obvious and it's a point we make every conference call, Cisco will always be affected by major economic changes, capital spending patterns, new and existing competitors and our ability to execute or not on our strategy and other factors we discussed in our financial reports.

We are also assuming that our vision of how the industry and the market will evolve will be accurate and we will execute effectively on that vision. Once again with the usual caveats, our Q3 fiscal year 2008 guidance is for revenue growth of approximately 10% year-over-year. Our long-term growth opportunities remain in the 12 to 17% range, assuming our usual caveats.

We will focus on what we can control and influence and attempt to position Cisco to gain momentum in market transitions, whether they are industry consolidation, product transitions, market adjacency opportunities or economic.

In summary, for those areas that we can control, we believe that our vision, strategy and execution are in great shape and producing results. As always, I want to thank our shareholders, customers, employees and partners for their support and continued confidence in our ability to execute during rapid industry consolidation, market transitions, and challenging economic times.

Closing Remarks

Now Blair, I'd like to turn it back over to you.

Great. Thank you, John. We're now going to open up the call to questions and answers.

The prepared remarks set forth above and the related conference call 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 our execution against our long-term strategy, our ability to understand and act upon key market transitions, our product momentum and our ability to drive long-term shareholder value) 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 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; dependence on the introduction and market acceptance of new product offerings and standards; rapid technological and market change; manufacturing and sourcing risks, including risks related to our lean manufacturing model; product defects and returns; litigation involving patents, intellectual property, antitrust, shareholder and other matters, and governmental investigations; natural catastrophic events; a pandemic or epidemic; achievement of the benefits anticipated from our investments in sales and engineering activities; our ability to recruit and retain key personnel; our ability to manage financial risk; risks related to the global nature of our operations, including our operations in emerging markets, currency fluctuations and other international factors; potential volatility in operating results; and other factors listed in Cisco's most recent reports on Forms 10-K and 10-Q. 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 Forms 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 26, 2008 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.