

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.
Q3 FY 2010 Earnings Conference Call
Wednesday, May 12, 2010
1:30pm PT

Introduction

Welcome to Cisco Systems Third Quarter Fiscal Year 2010 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. Laura Graves, Director of Global Investor Relations Corporate Communications for Cisco Systems. Ma'am, you may begin.

Thank you operator. Good afternoon everyone and welcome to our 81st quarterly conference call. This is Laura Graves and I am joined by John Chambers, our Chairman and CEO; Frank Calderoni, Executive Vice President and Chief Financial Officer; Rob Lloyd, Executive Vice President of Worldwide Operations; Ned Hooper, Chief Strategy Officer and Senior Vice President of our Consumer Business; and Padmasree Warrior, our Chief Technology Officer.

The Q3 fiscal year 2010 press release is on the 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 the financial information that we cover during this conference call, as well as additional financial metrics and analysis that you may find helpful.

Downloadable Q3 financial statements will be available following the call, including revenue by product and geography. 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 these documents.

A replay of this call will be available via telephone from May 12th through May 19th at 866-357-4205 or 203-369-0122 for international callers. A replay will also be available from May 12th through July 23rd on Cisco's Investor Relations website, <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 Annual Report on Form 10-K, Quarterly Report on Form 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. And finally, unauthorized recording of this conference call is not permitted.

And with that, I'd like to turn it over to John for his commentary on the quarter.

Opening Remarks

Laura, thank you very much. During the opening comments of the conference call, I will focus on what I view to be the key takeaways for Q3 fiscal year 2010. First, a very candid discussion about what we are

seeing in the market on a global basis relative to Q3 and its effect on our Q4 fiscal 2010 expectations; second, an update on our rapidly improving financial measurements and some interesting geographic, product, acquisition and customer segment metrics; third, a high level summary of what you see in terms of where we're placing our risk investments and results in some market adjacencies; and then finally our revenue guidance for Q4 with the appropriate caveats.

Following my opening comments, Frank will provide additional detail on Q3. In the third section we will focus on business momentum from a strategy, customer segment, geographic and product basis. Frank will then follow with additional financial parameters around our guidance. I will then wrap it up with some comments in terms of Cisco's momentum going into Q4, and finally our Q&A session.

From a summary point of view, I think there were a number of key takeaways from the results in Q3 and I will attempt to cover these at this time. First, the financial results were outstanding and very well balanced across key areas, achieving record level results from both total revenue and earnings per share from a GAAP and a non-GAAP basis.

Revenues of \$10.4 billion, an increase of approximately 27% year-over-year was above our guidance provided last quarter of 23 to 26%. Non-GAAP earnings per share were \$0.42, a 40% year-over-year increase. GAAP earnings per share were \$0.37, a 61% increase year-over-year. Expense management was solid with non-GAAP operating expenses as a percentage of revenue at 36.3%.

Non-GAAP product gross margins were very solid at 65.3%. Cash generated from operations in Q3 was approximately \$3 billion and we repurchased \$2.2 billion of stock during the quarter under our repurchase program. Non-GAAP operating income as a percentage of revenue was 28.8%. Non-GAAP net income of \$2.5 billion was up 41% year-over-year. Product book-to-bill was approximately 1. As a reminder, Q3 had one extra week in the quarter which occurs approximately every five to six years.

The market over the last year and a half has evolved pretty much as we expected and indicated in our conference calls. In fiscal year 2009 the first three quarters had negative sequential growth in both orders and revenues. Q3 of that year was the bottom and Q4 was clearly the tipping point returning to normal sequential growth, that is Q3 to Q4 of fiscal year 2009, especially in orders but also in revenues.

In fiscal year '10, each of the quarters to date has shown very solid sequential and year-over-year growth. As we stated in prior conference calls, Q1 FY10 acceleration was in the first phase of the recovery and in our opinion, Q2 marked the second phase of capital spending of the recovery with additional across the board acceleration in all of our geographies and market segments. This quarter, Q3, we saw a return to both balance across geographies and customer segments that we haven't seen since before the global economic challenges began.

There are three key takeaways in my mind for the quarter. First, Q3, in my opinion, is the proof point to having achieved our goals and aspirations in terms of how we handle very challenging economic times. We emerge from this downturn gaining market share, a larger share of the total wallet spend of our customers, dramatically improved customer relations as a trusted technology and business partner, and having next generation products in almost every product category.

Second, our innovation and operation engine is hitting on all cylinders. This applies to products, organization structure, business models and movements into 30+ new market adjacencies. And third, from almost every measurement perspective, whether revenues, earnings per share, new product introductions, successful acquisitions, leading in economic challenges, internal startups and many more, this quarter was probably the strongest quarter we've had in our history.

In summary, our game plan for handling economic downturns hit on all cylinders. Q3 results are the proof points and was, in my opinion, the strongest across the board quarter in our history.

At this time I'd like to provide additional detail on the very positive order growth and balance across geographies and market segments. The balance was extremely strong across our four large geographic

theaters; all four growing in terms of orders, at or above 30% year-over-year. The U.S. continued its strong pace with very solid balance across enterprise, public sector, service provider, commercial and consumer, all growing in excess of 25% year-over-year.

Our Emerging Markets theater which does not include China or India, returned to very solid growth comfortably above 40% year-over-year for the quarter. As a reminder, in Q2 our Emerging Markets group was flat year-over-year, so major improvement. Asia Pacific grew over 30%, again with very solid balance across key customer segments. I know there are many questions about our business momentum in Europe. We were very pleased with our European year-over-year growth numbers of approximately 30%. Our smallest theater, Japan, which represents about 3% of our business grew in low single digits from an order perspective.

Although it's hard to know for sure the benefits of the extra week in the quarter in terms of orders and revenues, our best estimates with all the appropriate caveats is that it probably contributed an additional 4-5% in year-over-year growth terms.

Now on to additional detail from a country perspective which was equally as encouraging. Two quarters ago only two of our top 15 countries saw year-over-year positive growth. Last quarter 8 of our top 15 countries saw year-over-year positive growth. In Q3, 12 of our top 15 countries saw orders in excess of 20% and all but one saw positive order growth.

Our new innovative, dynamic network organization structure of councils, boards and working groups, as discussed in the last few calls, is operating very effectively and has been an important part of managing through the recent downturn and then position us for the acceleration of results achieved in Q3. These structures allow speed, scale, flexibility and rapid replication.

During the last year we have completely enhanced our routing, switching, advanced technology and consumer product lines. Growth in terms of orders were all approximately 25% or better year-over-year and the new products such as our Nexus product family, our ASR product family, new fixed switching, the 2K and 3K, are producing growth results at the high end of our expectations.

The details supporting the new products success is really impressive. The following is a quick summary of year-over-year growth rates for these new products. The Nexus 2000 is up 431%. The Nexus 5000 is up 315%. The Nexus 7000 is up 277%. The ASR 9000 is up almost 900%. Our UCS product line had sequential revenue growth of 168% from Q2 to Q3 and order growth of 83%.

For other new products that have recently been announced, the sequential order growth that is from Q2 to Q3, was also very strong. In terms of this quarterly sequential order growth, the ASR 5000 grew 243%, the ASR 9000 grew 110%, the ISRG2 grew 337%, the 1900 ISR grew 333%, the 2900 ISR grew 335% and the 3900 ISR grew 342%. Ned, that's probably as fast as we've ever done with new products in terms of rapid ramp-up for the next generation.

Obviously both our next generation product introduction pace and rapid customer acceptance of these new products across our entire product lines is extremely strong. In my opinion in fact, the best we've seen in the history of our company in terms of breadth and depth of this innovation engine with solid operational execution. Again I would not underestimate the role that the new organization structure and new business models have played in our ability to achieve the above mentioned results. We believe that these are sustainable, differentiated advantages for Cisco versus our peers in the market and are therefore continuing our optimism about gaining a bigger share of our customers' spending, even in areas where we already are the clear leader.

As we projected in prior conference calls, we had market share gains in both switching and routing. As an interesting supporting data point, our CRS-1 had year-over-year order growth of approximately 45% and our IP phones had order growth of approximately 57%. While it is still early in the integration stages for our two large acquisitions, Starent and Tandberg, the initial integration, internal integration, customer acceptance and excitement has gone even better than we could have expected. The two acquisitions

have had the broadest acceptance with our customers, almost without exception, of any acquisitions we've done at any time in terms of the initial integration.

Our focus, not on a standalone product but rather on a technology architecture tying together products from the data center to the home is gaining major traction with many of our customers. We are also seeing the expanding acceptance of our approach to business architecture across our leading customers. As an example, at one of our recent global technical advisory sessions with 30 of our largest customers and service providers and enterprise customers, I asked the key question, "Have we improved our position with you first in terms of our technology architecture over the last year and second in terms of our business architecture partnership over the last year?" Over 80% of the participants said we had improved while the remaining said that we were in the same position as a year ago. This feedback is well ahead of my expectations for this point in time. However, our challenge now is to repeat this in volume across our top thousand customers.

We exit Q3 with a compelling financial position and an innovation engine from both a technology and a business model perspective that should position us to expand our leadership in the marketplace, while at the same time moving effectively into 30+ market adjacencies. Our internal startups, partnerships and our acquisitions continue to fill out our architectural strategies and we believe innovation in our traditional routing and switching product families have had a very high probability of gaining market share.

For those areas that Cisco can influence and control, we feel that we are doing very well. The key market transitions relative to collaboration, virtualization and video networking which will drive productivity and growth in network loads for the next decade, are continuing to evolve even faster than we thought just several quarters ago. Again as an update, the new organization and business models have contributed in a major way to this quarter's productivity increase as measured by revenue per employee which was a very strong 28% productivity increase year-over-year, not including the recent acquisition of Tandberg.

While we attempt to be very transparent with what we are seeing in the market and have established a good track record in terms of seeing trends early, our views do not tend to change every month or every quarter, and even when they do evolve, to change dramatically is really the exception. It is with this consistency of staying focused on the long-term, while not getting distracted by the short-term market activities, that drives our strategy for future success.

While we believe the recovery is accelerating, no one knows for sure how long it will be, how long it will last, how strong it will be or the extent of new job creation, but as we said in prior quarter conference calls, we are going to continue to be very aggressive to position ourselves for an optimistic view of global economic growth while continuing to maintain tight financial measurements and aligning our resources to new opportunities. I believe Q3 was a very positive proof point that both our vision and strategy for our industry is evolving as expected. And at the same time, our ability to execute on the vision and strategy as demonstrated by the very strong Q3 results.

Given the Q3 financial results, productivity increases and successes in the new market, it is probably not a surprise to anyone that you will see us growing our expenses at a faster pace. As we continue to expand in our traditional business areas and move into the 30+ market adjacencies. As discussed in last quarter, we expect our headcount to grow in support of our additional growth investments, by 2,000 to 3,000 incremental external hires over the next several quarters. Net of acquisitions we added approximately 1,000 of those employees in Q3.

We expect to continue to be very aggressive in both our own internal innovation commitment as well as our partnership and acquisition strategies. For those Cisco employees listening, this growth in headcount will continue to be very targeted towards strategic opportunities, with focus on productivity improvements in many of our traditional functions, while adding resources to drive into these new market adjacencies.

Also as we've said in conference calls over the years, Cisco will always be affected by major economic changes, capital spending patterns, new and existing competitors, potential issues affecting our suppliers and our ability to execute or not on our strategy, and other factors as discussed in our SEC filings. For

purposes of our long-range goals 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 be effective in execution on that vision.

With all this in mind, we will continue to provide our guidance with all the appropriate caveats, one quarter at a time and encourage each of our shareholders to not get too far ahead of themselves on building on the positives of another very strong quarter. Given all the uncertainties regarding the strength and shape of the recovery, concerns about the recovery possibly slowing and unknown extent of job creation, we encourage you to wait for additional economic data before becoming too optimistic. This is what you would expect of Cisco and what I would encourage that from our shareholders.

Before providing guidance for Q4, let me remind you that Q3 had an extra week, which we now estimate to have accounted for 4% to 5% in terms of the year-over-year growth. Also as a reminder, when looking at comparisons of last year's Q4 fiscal year 2009 to Q4 fiscal year 2010, we are starting to see more typical comparisons. Q3 FY09 was the bottom, as we said earlier, from a Cisco perspective and Q4 was the tipping point, delivering very solid sequential order and revenue growth compared to Q3. A nice way of saying that Q4 is coming more in line from a comparison and a pattern we're used to seeing.

In terms of Q4 revenue guidance, I will provide the full Cisco year-over-year revenue growth, including our acquisition of Tandberg. Frank will provide additional details in his Q4 guidance discussion on sequential Q3 to Q4 comparisons, as well as our year-over-year comparisons. With this discussion in mind, our revenue guidance for Q4 fiscal year '10, including our usual caveats as discussed earlier and in our financial reports, is for revenue growth including Tandberg, to increase 25 to 28% year-over-year. As we've shared with you in prior conference calls, we will now return our primary focus on growth in terms of year-over-year rather than sequential growth.

In summary, we believe that we are well positioned in the industry, due in part to our new business models, in terms of vision, differentiated strategy and execution. We believe we are entering the next phase of the internet as growth and productivity will center on collaboration, video and virtualization enabled by networked Web 2.0 technologies. We will do our best to provide the product architectures and the expertise to partner with our customers in the implementation of these collaborative capabilities from a technology and business perspective. We will also share with our customers how we have done this internally. In short, we're going to attempt to execute a strategy over the next decade that is very similar to what we did in the early '90s, and as we said before, it powered our growth for the next decade. Now Frank, let me turn it over to you.

Financial Overview

Thank you, John. I'm pleased with the outstanding financial results for Q3 FY10, with the achievement of most metrics at or above the high end of our guidance and which demonstrates our ability to execute within our business model.

Total revenue for the third quarter was \$10.4 billion, an increase of approximately 27% year-over-year, above the high end of our guidance provided last quarter of 23 to 26% year-over-year. We did have an extra week this quarter which resulted in approximately a 4 to 5% increase in revenue year-over-year or 3 to 4% sequentially Q2 to Q3.

Total product revenue was \$8.4 billion, up 31% year-over-year. Switching revenue was \$3.7 billion, an increase of 40% year-over-year. Modular switching revenue was up approximately 45% year-over-year, while fixed switching increased 37% year-over-year. Our switching revenue for the quarter represents a record in dollar terms and the highest year-over-year switching revenue growth we've experienced in nearly a decade.

Routing revenue was \$1.7 billion, up 23% year-over-year, representing an increase of 37% year-over-year in High End, an increase of 1% in Mid Range and an increase of 7% in Low End. Advanced Technologies revenue totaled \$2.4 billion, representing an increase of 18% year-over-year. We saw

increases in Unified Communications of 26% and Wireless of 27%, Video Systems of 9% and Security was up 15% year-over-year.

Other product revenue totaled \$630 million, an increase of approximately 71% year-over-year. The year-over-year growth was led by strong sales of cable and optical products, the inclusion of sales of Flip video products from our Q4 2009 acquisition of Pure Digital, as well as solid growth in our Emerging Technologies, which includes Unified Computing, TelePresence and Physical Security among others.

Total services revenue was a record \$1.9 billion, up approximately 11% year-over-year. Services resumed double digit growth and actually continued to grow at a fairly consistent rate throughout fiscal years 2009 and 2010. We experienced an increase in total revenue across all geographic segments on a year-over-year basis. Year-over-year revenue ranged from an increase of approximately 15% in Europe, to approximately 41% in Asia Pacific theater. Revenue in the US and Canada theater was up approximately 29%, Japan was up approximately 25% and Emerging Markets was up approximately 30%.

Q3 FY10 total non-GAAP gross margin was 65.2%; down 0.4 percentage points quarter-over-quarter, and up 0.1 of a point year-over-year. For product only, non-GAAP gross margin for the third quarter was 65.3%, down 0.3 percentage points quarter-over-quarter. The decrease was primarily due to higher discounts, partially offset by higher volume and cost savings.

While we were pleased with our overall performance in gross margins this quarter, we do recognize that variability in product mix and other factors that will impact the gross margins. On a year-over-year basis, non-GAAP product gross margin was up 0.7 percentage points, primarily driven by higher volume, mix and cost savings, partially offset by higher discounts.

Our non-GAAP service gross margin for the third quarter was 64.8%, down from 65.9% last quarter and 67% in Q3 FY09. The service gross margin decrease quarter-over-quarter was primarily driven by mix and increased costs from the additional week, which resulted in greater headcount expense, partially offset by volume. The year-over-year decrease was driven by some similar factors.

Services margin 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 contract initiations and renewals.

Total gross margin by theater ranged from approximately 62.9% for Asia Pacific and Emerging Markets, to approximately 71.1% in Japan. We saw variability in our margins across theaters due to higher discounting, offset by cost savings and volume. Gross margins increased on a year-over-year basis in Emerging Markets, Japan, Asia Pacific and Europe and decreased quarter-over-quarter. US and Canada declined year-over-year and was flat quarter-over-quarter.

Non-GAAP operating expenses were approximately \$3.8 billion in Q3, up approximately 9% quarter-over-quarter, driven by the extra week and increased investments in product innovation and strategic growth opportunities. Non-GAAP operating expenses were up 20% year-over-year. The expenses associated with the extra week in the quarter contributed approximately 4 percentage points of the year-over-year increase. Non-GAAP interest and other income was \$72 million for Q3. This amount reflects investment gains realized in our portfolio and a gain from the early termination of a lease agreement with a customer, partially offset by higher interest expenses from our recent bond offering.

GAAP interest and other income was \$58 million for the third quarter of FY10. Our Q3 FY10 non-GAAP tax provision rate was 19.1%. Our non-GAAP tax provision reflects a decrease in our forecasted effective tax rate for the fiscal year from 22% to 21% due to a relative increase in foreign income taxed at other than U.S. rates.

During Q3 FY10 the U.S. Court of Appeals for the Ninth Circuit affirmed a 2005 U.S. Tax Court ruling involving Xilinx. The case impacted the tax treatment of share-based compensation. While Cisco was not

a party to the case, the tax accounting change caused by the decision resulted in a tax benefit to Cisco of \$158 million, which was excluded from our non-GAAP earnings and our non-GAAP tax rate. This represents a reversal of the charge recorded in Q3 FY09.

Non-GAAP net income for the third quarter was \$2.5 billion, representing an increase of 41% year-over-year. As a percentage of revenue, non-GAAP net income was 23.9%. Non-GAAP earnings per share on a fully diluted basis for the third quarter was \$0.42 versus \$0.30 in the third quarter of fiscal year 2009, a 40% increase year-over-year.

GAAP net income for the third quarter was \$2.2 billion, as compared to \$1.3 billion in the third quarter of fiscal year 2009. GAAP earnings per share on a fully diluted basis for the third quarter were \$0.37 versus \$0.23 in the same quarter of fiscal year 2009.

We closed the Tandberg acquisition at the end of the third quarter and there was negligible impact on our income statement, while our balance sheet does fully reflect the impact of the close of the acquisition and the related purchase accounting. GAAP results include a \$14 million loss for Q3 related to our hedging of foreign currency considerations for our acquisition of Tandberg. While these hedges have resulted in GAAP losses of \$10 million year-to-date, they allowed us to effectively lock in a purchase price at currency levels more favorable than those prevailing when the deal was first announced.

Moving onto the balance sheet

Our balance sheet continues to be very strong, providing us with significant financial flexibility. The total of cash, cash equivalents and investments for the quarter was \$39.1 billion, down approximately \$530 million from last quarter. The Tandberg acquisition resulted in a net use of approximately \$2.6 billion of cash. During the quarter we generated \$3 billion cash from operations.

Moving on to accounts receivable

Our accounts receivables balance was \$4.1 billion at the end of Q3, down from \$4.2 billion at the end of Q2 FY10. At the end of Q3 days sales outstanding or DSO, was 39 days, remaining unchanged from the Q2 level that we had last quarter, and as compared to 27 days in Q3 FY09. DSO reflects a shipment profile fairly consistent with last quarter while also including the addition of Tandberg to our balance sheet late in the quarter.

As the technology industry moves to a recovering supply/demand environment, shifts in lead times and inventory levels will occur. We have improved our lead times throughout the quarter on most products and expect these lead times to continue to improve throughout the next quarter. I would like to acknowledge and thank our partners and our customers for their continued support as we have worked through this together.

Total inventory at the end of Q3 was \$1.3 billion, up approximately 3% quarter-over-quarter. Non-GAAP inventory turns were 11.1 this quarter, down 0.6 of a point from last quarter and up 0.4 over Q3 of last year. As part of the management of our supply chain, we enter into inventory purchase commitments as a normal course of business. These agreements allow our contract manufacturers and suppliers to procure inventory on our behalf, based on our expectations of customer demand over multiple quarters. Typically these agreements are firm and non-cancellable. Cisco's inventory purchase commitments at the end of Q3 were \$4.3 billion, an increase of approximately 30% from the end of Q2. These inventory levels and purchase commitments reflect our increased confidence, allow us supply chain flexibility and support anticipated higher business volumes and longer-term product demand projections in our business.

During the quarter we repurchased \$2.2 billion of common stock under the stock repurchase program or 87 million shares at an average price of \$25.76 per share. The remaining authorized repurchase amount under the stock repurchase program was approximately \$9.3 billion at the end of the quarter.

Deferred revenue was \$10.3 billion at the end of Q3, up approximately 7% quarter-over-quarter and an increase of approximately 17% compared with Q3 FY09. Deferred product revenue was \$3.5 billion and deferred service revenue was approximately \$6.8 billion, increases of approximately 28% and 13% year-over-year respectively.

At the end of Q3, our headcount totaled 68,574 an increase of approximately 2,700 from last quarter or a net increase of 1,000 aside from the acquisition of Tandberg.

Summary

In closing, from a financial perspective this was an outstanding quarter for Cisco. Based upon the robustness of our product and services portfolio we have seen our business return to a financial position that we believe is in many cases stronger than where we were prior to the economic downturn. This strong financial position provides Cisco a solid foundation for continued innovation and strategic investments which we believe will allow us to capitalize on the significant growth opportunities that are ahead of us.

I'll now turn it back to you, John.

Customer Segment, Geographic, and Product Review

Frank, thank you. Well done. Now moving on to the discussion of our strategy, customer segments, geography, product review, etc. Q3 continued to trend the balance between innovation and operational effectiveness in almost every aspect of our business. In recent past conference calls we have gone into certain important discussions of our strategy and we will continue this trend in most of our future calls. However, given the very strong results of this quarter, we think the strategy speaks for itself and we will focus in this conference call on the normal customer segments, geographies and product results.

Now moving on to customer segments and geographies, where the discussion on a global basis will be measured by orders both year-over-year and at times sequentially. When you look at both product orders and geographies, what a difference a year makes. Q3 product orders were up approximately 34% year-over-year. Just one quarter ago product orders grew at an 11% pace; two quarters ago they were down in high single digits; and three quarters ago in comparing year-over-year numbers, they were down in the low 20s year-over-year.

Now on to the discussion, first as it relates to customer segments. Our service provider business on a global basis in terms of product orders in Q3 was up approximately 30% year-over-year. Commercial was up 40%. Enterprise was up 26% and consumer was up 50% - in fact over 50%. Ned, sorry about that. He just kicked me under the table.

In terms of geography, which is the primary way we run the business, results across all four of our largest theaters was remarkably consistent in terms of enterprise, public sector, service provider, commercial and consumer, with every customer segment in each of our four largest theaters growing approximately 20% or better year-over-year. Again, the total U.S. grew year-over-year approximately 34%, Europe approximately 30%, Emerging Markets in the high 40s, Asia Pacific approximately 34%. The balance across these customer segments was remarkably very solid in each of these theaters as well. Japan continues to see some challenging economic times and our growth in Japan was up 2% year-over-year.

In the U.S. to provide additional detail, the enterprise grew 27%, public sector 44%, service providers grew 30%, commercial grew 34%, and consumer grew 64% on a year-over-year basis. Given the interest that many of you have on specific countries around the world, especially as it relates to Europe, the following is the summary of some of our top countries year-over-year growth.

The U.K. grew 28%, Germany grew 12%, France grew 27%, the Netherlands grew 23%, Italy was down 1%, and Switzerland grew 28%. And the rest of the world Canada grew 36%, Australia grew 22%, Brazil grew 80%, India grew 40%, Mexico grew 63%, China grew 24%, and Russia grew 31% year-over-year.

We also saw outstanding year-over-year and sequential improvement in the product numbers in Q3. The following discussion of products will be in terms of revenues year-over-year. As you would expect given product book-to-bill of approximately 1, product orders and product revenues in each of the product categories were relatively close in terms of year-over-year numbers. Again, product revenues grew approximately 31% year-over-year while orders grew approximately 34%. Service revenues grew approximately 11% year-over-year.

We made major improvements in our order lead times during Q3 and anticipate bringing the remaining product lead times back into our desired range in Q4, assuming there are no major surprises in our supply chain. However, while we are seeing improvements, the supply chain for the industry still has some challenges. Our core switching revenue growth was extremely strong with approximately 40% year-over-year growth. The balance was also very strong between modular and fixed switching growing 45% and 37% year-over-year respectively.

As we mentioned earlier, the new switching products were very strong in terms of new switching products the Nexus 7000 from a revenue perspective grew 281% and now has an annualized run rate of over \$1 billion. The Nexus 5000 continued with very strong revenue growth year-over-year of 425% and at a current run rate of \$250 million a year. The Nexus 2000 revenue run rate is now above \$160 million on an annualized basis and achieved year-over-year revenue growth of 486%.

Our core routing products also had a very strong quarter with revenues up 23%. High End routing which as we currently have it classified represents about two-thirds of our total routing business grew an outstanding 37%. In terms of new routing products, we again saw very strong year-over-year growth in revenues.

The ASR 9000 with an annualized revenue run rate of over \$160 million grew 740% year-over-year and 180% quarter to quarter. Of potential equal importance is the number of ASR customers, particularly large service providers, which grew from about 45 in Q2 to approximately 100 in Q3. And for the total ASR family of the ASR 1000, the 5000 and 9000, the number of customers moved approximately from 1,600 in Q2 to 2,350 customers in Q3. Once again, a very strong indicator of future growth opportunities.

The ISR G2 achieved a run rate in its second revenue generation quarter of an annualized \$500 million, up sequentially 429%. The ISR 3900 achieved an annualized run rate of over \$200 million and increased sequentially Q2 to Q3 at 489%. The ISR 2900 is on a revenue run rate of approximately \$250 million and achieved sequential growth of 371%. The ISR 1900 is just starting to ship and is off to a good start. The ASR 5000 from the Starent acquisition is at an order run rate of over \$350 million a year.

The key takeaway from these outstanding year-over-year and quarter-over-quarter growth numbers for our newly introduced products is how fast they are ramping up and how fast our customer base is expanding using these new products. And it's going across all of our new innovative product lines with this type of success. I have never seen this broad a base of new product families with this broad a balance and extremely rapid growth rates in my career from any high tech company.

In other product areas of interest, security grew year-over-year approximately 15% with over \$400 million in revenue in Q3. Unified communication grew 26% with approximately \$720 million in revenue. Wireless grew 27% with approximately \$270 million in revenue in Q3. And storage grew 100% with approximately \$140 million in revenue. Video systems grew 9% with approximately \$580 million in revenue. ANS grew 22% with approximately \$100 million in Q3. And optical revenue grew 15% year-over-year with approximately \$170 million in revenue.

From a revenue perspective the CRS product family grew 75% year-over-year to an annualized run rate of approximately \$1.4 billion. But I think it is even more important than the growth rate with the CRS family that the next generation of the internet built around the CRS 3 with its ability to do a billion videos, is in a multiyear leadership position we now have versus the core compared to all of our competitors. IP phones grew year-over-year 45% with approximately \$225 million in revenue in Q3.

I'd like to spend a few minutes on the Data Center growth opportunity in front of us and highlight the early successes we've seen. As we stated previously, we believe that data center virtualization has quickly emerged as a major disruption and represents a key market transition in transforming the data center into a more agile and efficient infrastructure, culminating into a compelling growth opportunity with over \$85 billion in total addressable market by 2015. Cisco in my opinion is best positioned to lead the transformation of the next generation data center and with our end to end architecture approach to enable a market transition and accelerate the adoption of virtualization by delivering a unique architecture to our customers that can lay down the foundation for them to journey from virtualization to building clouds going forward.

Last quarter conference call you asked us for an update on the data center and UCS momentum. The core Nexus 7000, 5000, 2000 product lines now have over 2,000 customers and have hit the key milestone of 1 million 10 gigabit Ethernet ports shipped. The UCS system continued its strong customer acceptance with an annual revenue run rate of \$200 million, up 186% sequentially from a revenue perspective. The UCS customer base has more than doubled since last quarter which was about 370 if I remember right, to currently over 900 customers, nearly all of the UCS customers were competitive wins versus large incumbents.

Customer acceptance is very strong with the majority of initial buyers coming back with repeat purchases. We've seen strong traction in all verticals within the enterprise segment. We built a powerful global partner ecosystem, introduced VCE coalition with the vBlock offering and Acadia, a joint venture Cisco-EMC, now led by industry CEO veteran Michael Capellas to expand our data center growth opportunity and enable customers' move to cloud computing.

Our architectural sales approach is rapidly not only gaining traction but accelerating. This is different than the standalone product approach of our competition. Simply put, Nexus sales pull through UCS, UCS sales pull through Nexus, Vblock sales pull Nexus, UCS, VMware and EMC sales. Key takeaway, Cisco's momentum in the data center is rapidly accelerating.

The second area that you asked us to cover in last quarter's conference call was an update on TelePresence and how we're doing with the Tandberg acquisition. The Tandberg acquisition has gone extremely smooth from a customer, employee retention and business integration perspective. As a reminder, the integration was just formally approved approximately two weeks before the end of Q3.

Every customer I have met that has either a Cisco or a Tandberg installed is extremely positive on the combination. With the key takeaways being a continued acceleration of next generation video conferencing capabilities and the business model changes. And we're starting to get our first joint wins together, even though it's only been in position for two weeks. Last calendar year, Tandberg's full year results were approximately \$900 million.

Now moving on to Cisco TelePresence. We continue to see solid acceleration during Q3 with orders increasing year-over-year by approximately 50%. The current annualized run rate is approximately \$175 million based on Q3 order rates. We are beginning to see the very large wins with a 200+ initial commitment of high-end Cisco TelePresence during Q3. One of those was Bank of America, which will deploy over 200 systems initially, while another of the wins was in an emerging country's government social services area where we received an initial order for 250 systems. We announced 5 new TelePresence experiences, bringing our total to 10, which include board room, broadcast, financial services expert, lobby ambassador and media solutions.

As we begin to focus on key vertical applications, there were three major areas that I would like to briefly discuss as it relates to video capability. First, Cisco announced Cisco Health TelePresence, a unique TeleMedicine experience and we are seeing major global interest. In education, Duke University announced their classroom of the future, tightly integrating Cisco's TelePresence into a new education experience.

And third in retail British Telecom announced an novel use of Tandberg TelePresence deploying “Virtual Fitting Rooms” at Tommy Hilfiger. Video capability is obviously one of the key drivers of network loads, changing business models and potential major productivity improvements in every industry vertical. While we traditionally do not break future growth rates down by individual product families, I believe it is fair for you to ask our expectations of growth from this combination with all of the appropriate caveats. I believe that a good job for the combined TelePresence business, Tandberg and Cisco's TelePresence, would be for growth in the next fiscal year to be in the mid 20s, before any adjustments based on deferred revenue from the Tandberg acquisition.

A third area that you asked us to discuss in last quarter's conference call was the Starent acquisition. In many of our customer environments the Starent acquisition was a tipping point in Cisco's architectural play, from the core to the edge, wired and wireless, of the large service provider networks. Growth rates over the next year for the product family with all the appropriate caveats are forecast by our team to be in the mid 20s.

On a last note, both the Starent and Tandberg acquisitions, not only are they off to an extremely strong start from business momentum, business integration and culture match, they have probably, I think Ned, been the two of our smoothest large acquisitions that we've ever done. Your team's getting good at that but I think the cultures are getting well and good selection by the way.

Vision, Strategy, Execution

In summary, although we would all like to avoid the downturns, our vision of how the industry is going to evolve appears to be playing out very much as we expected. We believe 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 the results measured from a 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. And make no mistake about it, we are poised and ready to capitalize on the opportunities, especially those related to data center virtualization, collaboration, video and other market adjacencies.

Now I'll turn it back over to Frank for some additional financial guidance and other financial highlights. Frank, back to you.

Financial Guidance

Thanks 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 a reconciliation to GAAP.

For Q4 FY10, we anticipate total revenue to be up approximately 25 to 28% year-over-year. Because the sequential increase between Q3 and Q4 needs to be adjusted for a few one time items, we want to also provide a quarterly guidance bridge here. Our analysis of historical quarter-over-quarter growth between fiscal Q3 and fiscal Q4 results in a typical sequential increase of approximately 5 to 6%. On a sequential Q3 to Q4 basis, the impact of the extra week in Q3 is 3 to 4% of total revenue. This should be reduced from a normal sequential increase as we return to a 13-week quarter in Q4.

Additionally, please note that throughout 2009, Tandberg recorded revenue in the range of approximately \$200 to \$300 million per quarter, depending upon seasonality. Based upon projected revenue after adjustments for purchase accounting and for normal Tandberg seasonality, we believe Tandberg will contribute 2% to the sequential growth in Q4 or approximately \$200 million which is also included in our revenue guidance for Q4.

If you assume a normal sequential increase of 5 to 6%, reduced by the 3 to 4% for the extra week, then adding 2% for Tandberg, we arrive at approximately a 3 to 5% increase on a sequential basis for Q4

FY10. On a year-over-year basis this equates to 25 to 28% guidance for Q4 FY10. At this point let me remind you in light of Regulation FD, Cisco will not comment on its financial guidance during the quarter unless it is done through an explicit public disclosure.

Let me now give you some additional details on the Q4 financial guidance.

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 Q4 will be approximately 64% to 65%, reflecting the revenue guidance I just shared with you. With recent acquisitions and our continued growth into some lower margin markets, gross margin could be negatively impacted by product mix. There will be times when we will be at the high end of this range, but would encourage you to be conservative in your short and long term modeling.

We believe Q4 operating expenses will be approximately 36.5% to 37% of revenue. We expect interest and other income to be approximately \$10 million in the fourth quarter. Our tax provision rate for Q4 is expected to be approximately 21%.

We are modeling share count to be down approximately 10 million shares quarter-over-quarter 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 fourth quarter of FY10. While we expect to continue our share repurchase program, it is difficult to predict the exact weighted average shares outstanding. As a point of reference, a \$1.00 movement in our average stock price would change the calculated shares outstanding for purposes of determining earnings per share, by approximately 17 million.

While we are extremely pleased with our Tandberg acquisition and our customer buy-in to our collaboration strategy, going forward in the near-term, we expect the impact of Tandberg to be slightly dilutive to our non-GAAP EPS by slightly less than \$0.01 per share on a quarterly basis.

Regarding cash flow from operations, we would expect to generate \$2 billion to \$2.5 billion during the fourth quarter. For our Q4 FY10 GAAP earnings, we anticipate that GAAP EPS will be \$0.06 to \$0.09 per share lower than our non-GAAP EPS, primarily due to stock compensation expense and acquisition related charges. Please see the slides that accompany this webcast for more detail.

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 to you John.

Summary

Thank you Frank. The following is a summary of my views of Cisco's momentum and opportunities entering Q4 of fiscal year 2010. As we've discussed in some detail during the call, it has really been a pleasure watching the steady evolution of business momentum improving for Cisco over the last year. Our early optimism about the economic downturn over a year ago in the January and February and March period of 2009 turned out to be very accurate. We have continued to see the momentum improve each quarter and the results of this quarter were truly outstanding, although helped by an extra week as discussed earlier.

Our long-term comfort level with our goal of 12 to 17% year-over-year growth with all the appropriate caveats, appears to be even more likely and our current guidance for Q4 year-over-year growth in the 25 to 28% is obviously well above our long-term goal of 12 to 17%. Our balance of innovation as illustrated from almost a complete product refresh cycle across every major product family as well as our technology architecture really coming to life and most of our customers understanding, is achieving the desired results.

While it's still early in the business architecture innovation with our leading edge customers, we are also achieving and often over-achieving the desired results in both customer business partnerships as well as our revenue growth and market share objectives. Our new innovative, dynamic networked organization structure consisting of councils, boards and working groups, are clearly getting the results as indicated in proof points from Q2 and Q3 and we are starting to see how our customers are having interactive discussions with us regarding how they can move the organization model to this new dynamic structure.

The key enabler of this organization structure and supporting business models is the intelligent network delivering both the communications and IT capabilities of a company. At the forefront of these market transitions is video, data center virtualization and collaboration. In terms of the new emerging technologies that are enabling the desired government and business results for the future.

So in summary, while there are always challenges in front of us from the economy, job creation, competition, supply chain, regulatory environment and many other factors, that could be a surprise to us versus our expectations and guidance, we are in my opinion the best positioned we've ever been to achieve our long-term goals and aspirations. We will continue to attempt to be as transparent in terms of our views of the economic challenges, especially in Europe as well as other challenges that we've discussed on this and prior calls. And as we said many times before, it would not be a dramatic surprise to see our results differ in a given quarter either below or above our guidance.

Balance this quarter as evidenced from a country, theater, product family, customer segment and market adjacencies perspective was probably the best we've seen in recent history and definitely the best given our rapidly expanding role into 30+ market adjacencies. As you would expect given our productivity increases and the success in our innovation from both a product and a business perspective, we are going to expand our sales, engineering and other resources, especially in these new market adjacencies.

As we continue to aggressively invest we will also continue to maintain our focus on the financial models. Once again with our usual caveats as discussed earlier in our financial reports, our Q4 guidance is for year-over-year revenue to increase in the 25 to 28% range.

I want to thank the entire Cisco family for working together as a team to ensure that our company is in a solid position to not only weather the challenging economic environment but even more importantly, to be ready to continue to accelerate our investments, assuming the current trends hold. I know it has not been easy and we are all working hard to maintain our culture of innovation, trust, stretched mentality and giving back, all during a tough period of time for ourselves, our families and our friends.

While we expect a continued recovery throughout the entire year and we clearly gave a very aggressive forecast for Q4, it is important that expectations do not get ahead of market realities, especially until we see job creation. It would not be a big surprise to us to see economic growth and markets bounce up and down over the next 12 months and we strongly urge our investors not to dramatically change their models beyond Q4 guidance just given.

We will continue to share with you what we are seeing in the market and our own expectations for our business as transparently as we can.

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.

Laura, let me now turn it over to you for the Q&A session.

Thanks very much. And before we do that John, just real quickly, I want to confirm that our GAAP EPS will be between \$0.07 to \$0.09 per share lower than non-GAAP EPS. I think Frank we were talking a little fast and we said 6 to 9. It's actually \$0.07 to \$0.09. So with that, operator can we go ahead and open the call for questions please?

Closing Remarks

Cisco's next quarterly conference call, which will reflect our fourth quarter fiscal 2010 results, will be on Wednesday, August 11th, 2010, at 1:30 p.m. Pacific Time, 4:30 p.m. Eastern Time.

Additionally, downloadable Q3 FY10 financial statements will be available following the call, including revenue segments by product and geography. 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 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 is 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 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 our growth, strategy, results, share gains, and ability to generate cash) 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 market adjacencies and 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 and engineering 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, including relating to transactions to hedge foreign currency consideration for acquisitions; 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 Form 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 Form 10-K and Form 10-Q, as each may be amended from time to time. Cisco's results of operations for the three and nine months ended May 1, 2010 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.

