

CISCO SYSTEMS INC
Form 10-K
September 19, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended July 30, 2005

OR

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

For the transition period from _____ to _____

Commission file number 0-18225

CISCO SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

California
(State or other jurisdiction of)

77-0059951
(IRS Employer)

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

incorporation or organization)

Identification No.)

170 West Tasman Drive

San Jose, California
(Address of principal executive offices)

95134-1706
(Zip Code)

Registrant's telephone number, including area code: (408) 526-4000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$0.001 par value

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☒ No ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Aggregate market value of registrant's common stock held by non-affiliates of the registrant, based upon the closing price of a share of the registrant's common stock on January 28, 2005 as reported by the Nasdaq National Market on that date: \$114,480,738,406

Number of shares of the registrant's common stock outstanding as of September 9, 2005: 6,274,702,446

DOCUMENTS INCORPORATED BY REFERENCE

- (1) Portions of the registrant's Annual Report to Shareholders for its fiscal year ended July 30, 2005 are incorporated by reference into Part I and Part II of this Annual Report on Form 10-K where indicated.

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

- (2) Portions of the registrant's Proxy Statement relating to the registrant's 2005 Annual Meeting of Shareholders, to be held on November 15, 2005, are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.
-

PART I

| | | |
|---------|--|----|
| Item 1. | <u>Business</u> | 1 |
| | <u>General</u> | 1 |
| | <u>Products and Services</u> | 1 |
| | <u>Customers and Markets</u> | 4 |
| | <u>Sales Overview</u> | 5 |
| | <u>Acquisitions, Investments, and Alliances</u> | 6 |
| | <u>Backlog</u> | 6 |
| | <u>Competition</u> | 7 |
| | <u>Research and Development</u> | 8 |
| | <u>Manufacturing</u> | 8 |
| | <u>Patents, Intellectual Property, and Licensing</u> | 8 |
| | <u>Employees</u> | 9 |
| | <u>Risk Factors</u> | 10 |
| | <u>Executive Officers of the Registrant</u> | 23 |
| Item 2. | <u>Properties</u> | 25 |
| Item 3. | <u>Legal Proceedings</u> | 26 |
| Item 4. | <u>Submission of Matters to a Vote of Security Holders</u> | 26 |

PART II

| | | |
|----------|--|----|
| Item 5. | <u>Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u> | 27 |
| Item 6. | <u>Selected Financial Data</u> | 27 |
| Item 7. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 27 |
| Item 7A. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 27 |
| Item 8. | <u>Financial Statements and Supplementary Data</u> | 28 |
| Item 9. | <u>Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u> | 28 |
| Item 9A. | <u>Controls and Procedures</u> | 28 |
| Item 9B. | <u>Other Information</u> | 28 |

PART III

| | | |
|----------|---|----|
| Item 10. | <u>Directors and Executive Officers of the Registrant</u> | 29 |
| Item 11. | <u>Executive Compensation</u> | 29 |
| Item 12. | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> | 29 |
| Item 13. | <u>Certain Relationships and Related Transactions</u> | 29 |
| Item 14. | <u>Principal Accountant Fees and Services</u> | 29 |

PART IV

| | | |
|----------|---|----|
| Item 15. | <u>Exhibits and Financial Statement Schedules</u> | 30 |
| | <u>Signatures</u> | 34 |

This Annual Report on Form 10-K, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, which is incorporated by reference from our 2005 Annual Report to Shareholders, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act). These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, continues, may, variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under Risk Factors, and elsewhere herein and in the 2005 Annual Report to Shareholders. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

PART I

ITEM 1. Business

General

We manufacture and sell networking and communications products and provide services associated with that equipment and its use. Our products are installed at corporations, public institutions, telecommunication companies, and commercial businesses and are also found in personal residences. We provide a broad line of products for transporting data, voice, and video within buildings, across campuses, and around the world. We conduct our business globally and are managed geographically in four segments: the Americas; Europe, the Middle East, and Africa (EMEA); Asia Pacific; and Japan. For revenue and other information regarding these segments, see Note 12 to the Consolidated Financial Statements in our 2005 Annual Report to Shareholders, which is incorporated into this report by reference. As a result of organizational changes, beginning in fiscal 2006, our reportable segments will be changed to the following theaters: United States and Canada; European Markets; Emerging Markets; Asia Pacific; and Japan. The organizational changes are designed to align our focus on long-term growth, capture emerging market opportunities, and serve our customers better.

We were incorporated in California in December 1984, and our headquarters are in San Jose, California. The mailing address of our headquarters is 170 West Tasman Drive, San Jose, California 95134-1706, and our telephone number at that location is (408) 526-4000. Our Website is www.cisco.com. Through a link on the Investor Relations section of our Website, we make available the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission (SEC): our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. All such filings are available free of charge.

Products and Services

We sell scalable, standards-based networking products that address a wide range of customers' business needs, including improving productivity, reducing costs, and gaining a competitive advantage. Our corresponding technology focus is on delivering networking products and systems that simplify customers' infrastructures, offer integrated services, and are highly secure. Our products and services help customers build their own network infrastructures while providing tools to allow them to communicate with key stakeholders, including customers, prospects, business partners, suppliers, and employees.

Our products are used individually or in combination to connect computing devices to networks or computer networks with each other whether they are within a building, across a campus, or around the world. Our breadth of product and service offerings enables us to offer a wide range of products and services to meet customer requirements. We also provide products and services that allow customers to transition their various networks to a single multiservice data, voice, and video network.

We refer to some of our products and technologies as advanced technologies, and we believe some of these advanced technologies may grow over time to become material contributors to our overall business. Each of these advanced technologies and our core switching and routing businesses builds upon our existing competencies. We have currently identified six advanced technologies for particular focus: enterprise IP communications, home networking, optical networking, security, storage area networking, and wireless technology. We are in the process of identifying additional advanced technologies for focus and investment in the future, and our investments in some presently identified advanced technologies may be curtailed or eliminated depending on market developments.

Over time, we believe that the Internet and the various networks associated with it, including corporate intranets, cable, broadband and dialup networks, and voice and video networks, will evolve to include embedded resources and the virtualization of applications and services to produce an integrated, intelligent system or, as we refer to it, an Intelligent Information Network. This is our vision for the evolution of networking from connectivity products to intelligent systems. In this evolving environment, we believe successful vendors will be capable of providing a broad spectrum of products aimed not at a particular technology platform but at solutions to networking problems that span all segments. As such, many of our strategic initiatives and investments are aimed at meeting the requirements that an Intelligent Information Network would demand. For a discussion of the risks associated with that strategy, please see the section of this report entitled Risk Factors, including the risk factor entitled We depend upon the development of new products and enhancements to existing products, and if we fail to predict and respond to emerging technological trends and customers changing needs, our operating results and market share may suffer. For information regarding sales of our major products and services, see Note 12 to the Consolidated Financial Statements in our 2005 Annual Report to Shareholders, which is incorporated into this report by reference.

Our offerings fall into several categories:

Routing

Routing technology is the foundation of a computer network. Routers interconnect computer networks, moving information such as data, voice, and video from one network to another. Our routing products offer features designed to increase the intelligence, security, reliability, and level of performance in the transmission of information. We offer a broad range of routers, from core network infrastructure for service providers and large businesses to home network deployments for telecommuters and consumers.

Switching

Switching is another integral networking technology that is used in buildings and campuses to build local-area networks (LANs), across cities to build metropolitan-area networks (MANs), and across great distances to build wide-area networks (WANs). Our switching systems offer many forms of connectivity to end users, workstations, and servers, and function as aggregators on LANs, MANs, and WANs. Our systems employ several widely used technologies including Ethernet, Gigabit Ethernet, 10 Gigabit Ethernet, Asynchronous Transfer Mode, packet over SONET, and Multiprotocol Label Switching.

Advanced Technologies

Enterprise IP Communications

We provide enterprise IP communications products which enable the transmission of voice services (including traditional phone calls; voicemail and voice messaging; audio, Web, and videoconferencing; and contact centers) over open, standards-based Internet Protocol (IP)-based networks. Our enterprise IP communications products support the convergence of data, voice, and video services over a single IP network, providing both cost savings and enhanced personal and business productivity. Because our enterprise IP communications products and services are designed to interoperate with most existing legacy equipment, customers can migrate to an all-IP network at a pace that meets their business needs.

Home Networking

Home networking products connect, in a wired or wireless format, different devices in the household, allowing users to share Internet access, printers, music, movies, and games throughout the home. Our products include routers, network cards, media adapters, Internet video cameras, network storage, USB adapters, and other products that enable customers to share an Internet connection or move content around their homes or small-office environments. These products are sold through our Linksys division.

Optical Networking

We provide optical networking products for both the enterprise and service provider markets. Our optical networking products provide an evolutionary path for telecommunications carriers, cable operators, and enterprises from their existing infrastructures as well as giving newer carriers and enterprises the foundation and capability to offer and deploy cost-effective, multiservice networks that can support data, voice, and video. We support optical technologies such as Synchronous Optical Network/Synchronous Digital Hierarchy (SONET/SDH), dense wavelength-division multiplexing (DWDM), and coarse wavelength-division multiplexing (CWDM), which are used to scale optical bandwidth as high-bandwidth applications, such as Gigabit Ethernet and storage, become more commonplace.

Security

We provide a wide range of network security products and services that offer protection to critical information systems from unauthorized use, that defend against attack, and that minimize the effect of Internet-borne worms and viruses. As part of our Self-Defending Network strategy, we offer numerous network security technologies within our family of routers and switches, in standalone security appliances, and as host-based software agents with central management and analysis. Our network security product and service offerings are designed to help ensure the integrity of the information network, simplify operations, and lower total cost of ownership.

Storage Area Networking

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

We provide storage area networking products that deliver standards-based connectivity between servers and storage systems, which can include products such as arrays and tape drives. Our products incorporate intelligent network features, such as advanced security, traffic management, virtualization, and tools that are designed to help make storing, retrieving, and protecting critical data across widely distributed environments more efficient.

Wireless Technology

We offer a broad variety of in-building and outdoor wireless LAN and wireless bridging products. These products include access points, wireless LAN controllers, an integrated wireless and wireline switching system, wireless LAN client adapters, bridges, antennas, and accessories. Our wireless networking products are designed

to provide high-performance, highly secure, manageable, and highly reliable wireless LANs that enable mobility and increase productivity.

Other Products

Our other products are comprised primarily of access and network management software products as follows:

Access

Our access products provide telecommuters, employees who are traveling, students, and other users who are located away from a firm's or institution's main offices with highly secure access to network applications and information. Our access products include asynchronous and ISDN remote-access routers, dialup access servers, wireless products, digital subscriber line (DSL) technologies, and cable universal broadband routers.

Network Management Software

Our enterprise and service provider customers depend on our network management products to provide continuous system operation, security, configuration, monitoring, network optimization, and end-user management. Utilizing our embedded instrumentation, interfaces, and application services and a portfolio of carrier-class, large-scale management products, we offer network management products across our product lines. We aim to bring state-of-the-art management capabilities to a converged network management solution covering all our network technologies and services with a high level of inherent security, network intelligence, and high availability. Our network management products include developer kits, application programming interfaces, and services to support customer integration into legacy systems and the integration of third-party products that complement our network management product portfolio.

Service

In addition to our product offerings, we provide a broad range of service offerings, including technical support services and advanced services. Technical support services help ensure that our products operate efficiently, remain highly available, and benefit from the most up-to-date system software. These services help customers to protect their network investments and minimize downtime for systems running mission-critical applications. Advanced services is a comprehensive program that is designed to provide responsive, preventive, and consultative support of our technologies for specific networking needs. The advanced services program supports networking devices, applications, and complete infrastructures.

Customers and Markets

Our customers' networking needs are influenced by numerous factors, including the size of the organization, number and types of computer systems, geographic location, and the applications requiring communications. Our customer base is not concentrated in any particular industry. In each of the past three fiscal years, no single customer has accounted for 10 percent or more of our net sales. Our customers are primarily in

the following markets:

Large Enterprise Businesses

We define large enterprise businesses generally as regional, national, or global organizations with 1,000 or more employees working in multiple locations or branch offices. They have complex IT infrastructure and networking needs within a multivendor environment. Our large enterprise customers include government, education, and healthcare organizations and retail, finance, manufacturing, and transportation entities. We create and deliver routing, switching, network security, enterprise IP communications, mobility, storage, and other products and services in collaboration with third-party application and hardware vendors and channel partners.

We also offer a wide variety of services, including service and support packages, financing, and managed-network-service offerings through our service provider partners.

Service Providers

Service providers offer data, voice, and video communication services to businesses, governments, utilities, and consumers. They include regional, national, and international telecommunications carriers, as well as Internet, cable, and wireless service providers. Service providers use a variety of our routing, switching, optical, storage, security, and network management products in their own core networks. Compared to other end-user customers, service provider customers are more likely to require network design, deployment, and support services. Additionally, many service providers offer managed network services incorporating our products for their residential, enterprise, and commercial customers.

Commercial

We define commercial customers primarily as small and medium-sized businesses having fewer than 1,000 employees and a need for networks of their own, as well as for connections to the Internet and to business partners. Smaller organizations generally have limited resources and expertise in networking technology. Therefore, we attempt to provide products that are affordable and easy to install and use. The commercial market remains an area of potential growth for network adoption and deployment of intelligent network.

Consumer

Consumer customers, primarily individuals and businesses operating in small offices or home offices, have infrastructure and networking needs on a smaller scale. We offer products to consumers through our Linksys division.

Sales Overview

As of the end of fiscal 2005, our worldwide sales and marketing organization consisted of approximately 14,000 individuals, including managers, sales representatives, and technical support personnel. We have field sales offices in more than 60 countries and sell our products and services both directly and through a variety of channels with support from our sales force. A substantial portion of our products and services is sold through our channel partners and the remainder is sold through direct sales. Our channel partners include systems integrators, service providers, other resellers, distributors, and retail partners.

Systems integrators and service providers typically sell directly to end users and often provide system installation, technical support, professional services, and other support services in addition to network equipment sales. Systems integrators also typically integrate our products into an overall solution and a number of service providers are also systems integrators.

Distributors stock inventory and typically sell to systems integrators, service providers, and other resellers. In addition, our Linksys division home networking products are generally sold through distributors and retail partners. We refer to sales through distributors and retail partners as

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

our two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. These distributors and retail partners are generally given business terms which allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs.

For information regarding risks related to our channels, please see the section of this report entitled **Risk Factors**, including the risk factors entitled **Disruption of or changes in our distribution model could harm our sales and margins** and **Our inventory management relating to our sales to our two-tier distribution channel is complex, and excess inventory may harm our gross margins**.

Our service offerings complement our products via a range of consulting, technical, project, quality, and maintenance services, including 24-hour online and telephone support through technical assistance centers.

We facilitate and provide lease and other financing through our wholly owned subsidiaries to certain qualified customers for the purchase of equipment and other needs. For additional information regarding these financing activities, see Note 6 to the Consolidated Financial Statements in our 2005 Annual Report to Shareholders, which is incorporated into this report by reference.

Acquisitions, Investments, and Alliances

The markets in which we compete require a wide variety of technologies, products, and capabilities. The combination of technological complexity and rapid change within our markets makes it difficult for a single company to develop all the technological solutions that it desires to offer within its family of products and services. Through acquisitions, investments, and alliances we are able to deliver a broader range of products and services to customers in target markets.

We employ the following strategies to address the need for new or enhanced networking products and services: we develop new technologies and products internally; we enter into joint-development efforts with other companies; we resell other companies' products; and we acquire all or parts of other companies.

Acquisitions

We have acquired many companies, and we expect to make future acquisitions. Mergers and acquisitions of high-technology companies are inherently risky, especially if the acquired company has yet to ship a product. No assurance can be given that our previous or future acquisitions will be successful or will not materially adversely affect our financial condition or operating results. Prior acquisitions have resulted in a wide range of outcomes, from successful introduction of new products and technologies to an inability to do so. The risks associated with acquisitions are more fully discussed in the section of this report entitled "Risk Factors," including the risk factor entitled "We have made and expect to continue to make acquisitions that could disrupt our operations and harm our operating results."

Investments in Privately Held Companies

In addition to passive portfolio investments, we make minority investments in privately held companies that develop technology or provide services that are complementary to our products or provide strategic value. The risks associated with these investments are more fully discussed in the section of the report entitled "Risk Factors," including the risk factor entitled "We are exposed to fluctuations in the market values of our portfolio investments and in interest rates; impairment of our investments could harm our earnings."

Strategic Alliances

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

We pursue strategic alliances with other companies in areas where collaboration can produce industry advancement and acceleration of new markets. The objectives and goals for a strategic alliance can include one or more of the following: technology exchange, product development, joint sales and marketing, or new-market creation. Currently, we have strategic alliances with Accenture Ltd; AT&T Corp.; BearingPoint, Inc.; Bell South Corporation; Cap Gemini S.A.; Electronic Data Systems Corporation; Ericsson; Fujitsu Limited; Hewlett-Packard Company; Intel Corporation; International Business Machines Corporation; Italtel SpA; Microsoft Corporation; Motorola, Inc.; SBC Communications, Inc.; Siemens AG; and Sprint Corporation; among others.

Backlog

Our backlog at July 30, 2005, the last day of our 2005 fiscal year, was approximately \$2.0 billion, compared with backlog of approximately \$1.9 billion at July 31, 2004, the last day of our 2004 fiscal year. Backlog

includes orders confirmed with a purchase order for products scheduled to be shipped within 90 days to customers with approved credit status. Because of the generally short cycle between order and shipment and occasional customer changes in delivery schedules or cancellation of orders (which are made without significant penalty), we do not believe that our backlog, as of any particular date, is necessarily indicative of actual net sales for any future period.

Competition

We compete in the networking and communications equipment markets, providing products and services for transporting data, voice, and video traffic across intranets, extranets, and the Internet. These markets are characterized by rapid change, converging technologies, and a migration to networking solutions that offer superior advantages. These market factors represent both an opportunity and a competitive threat to us. We compete with numerous vendors in each product category. The overall number of our competitors providing niche product solutions may increase. Also, the identity and composition of competitors may change as we increase our activity in our advanced technology markets. As we continue to expand our sales globally, we may see new competition in different geographic regions. In particular, we are seeing price-focused competitors from Asia, especially China, and we anticipate this will continue.

Our competitors include 3Com; Alcatel; Avaya; Avici Systems; Brocade Communications Systems, Inc.; Check Point Software Technologies; Ciena; D-Link Corporation; Dell; Enterasys Networks; Extreme Networks; F5 Networks, Inc. Force10 Networks, Inc.; Foundry Networks; Fujitsu; Hewlett-Packard Company; Huawei Technologies; Juniper Networks; Lucent Technologies; McDATA Corporation; NETGEAR, Inc.; Nokia; Nortel Networks; Redback Networks; Siemens AG; Sycamore Networks; and Symbol Technologies, Inc., among others.

Some of these companies compete across many of our product lines, while others are primarily focused in a specific product area.

Barriers to entry are relatively low, and new ventures to create products that do or could compete with our products are regularly formed. In addition, some of our competitors may have greater resources, including technical and engineering resources, than we do. As we expand into new markets, we will face competition not only from our existing competitors but also from other competitors, including existing companies with strong technological, marketing, and sales positions in those markets. We also sometimes face competition from resellers and distributors of our products. Companies with whom we have strategic alliances in some areas may be competitors in other areas.

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

The ability to provide a broad range of networking products and services

Product performance

Price

The ability to introduce new products, including products with price-performance advantages

The ability to reduce production costs

The ability to provide value-added features such as security, reliability, and investment protection

Conformance to standards

Market presence

The ability to provide financing

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

Research and Development

We regularly seek to introduce new products and features in areas including, routers, switches, advanced technologies, and other product technologies. Our research and development expenditures were \$3.3 billion, \$3.2 billion, and \$3.1 billion in fiscal 2005, 2004, and 2003, respectively. All of our expenditures for research and development costs, as well as in-process research and development of \$26 million, \$3 million, and \$4 million in fiscal 2005, 2004, and 2003, respectively, have been expensed as incurred.

The industry in which we compete is subject to rapid technological developments, evolving standards, changes in customer requirements, and new product introductions and enhancements. As a result, our success depends in part upon our ability, on a cost-effective and timely basis, to continue to enhance our existing products and to develop and introduce new products that improve performance and reduce total cost of ownership. In order to achieve these objectives, our management and engineering personnel work with customers to identify and respond to customer needs, as well as with other innovators of internetworking products, including universities, laboratories, and corporations. We also expect to continue to make acquisitions and investments where appropriate to provide us with access to new technologies. We intend to continue developing products that meet key industry standards and to support important protocol standards as they emerge. Still, there can be no assurance that we will be able to successfully develop products to address new customer requirements and technological changes or that such products will achieve market acceptance.

Manufacturing

We primarily employ an outsourced manufacturing strategy that relies on contract manufacturers for manufacturing services. Our manufacturing operations primarily consist of quality assurance of materials and components, subassemblies, final assembly, and testing of products. We presently use a variety of independent third-party companies to provide services related to printed circuit board assembly, in-circuit test, and product repair as well as product assembly. Proprietary software on electronically programmable memory chips is installed in our systems in order to configure products to customer needs and to maintain quality control and security. The manufacturing process enables us to configure the hardware and software in unique combinations to meet a wide variety of individual customer requirements. We also use automated testing equipment and burn-in procedures, as well as comprehensive inspection, testing, and statistical process controls that are designed to help ensure the quality and reliability of our products. The manufacturing processes and procedures are generally ISO 9001 or ISO 9003 certified.

Our arrangements with contract manufacturers generally provide for quality, cost, and delivery requirements, as well as manufacturing process terms, such as continuity of supply, inventory management, flexibility regarding capacity, quality and cost management, oversight of manufacturing, and conditions for use of our intellectual property. We have not entered into any significant long-term contracts with any manufacturing service provider. We generally have the option to renew arrangements on an as-needed basis, primarily annually. These arrangements generally do not commit us to purchase any particular amount or any quantities beyond certain amounts covered by orders or forecasts that we submit covering discrete periods of time.

Patents, Intellectual Property, and Licensing

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

We seek to establish and maintain our proprietary rights in our technology and products through the use of patents, copyrights, trademarks, and trade secret laws. We have a program to file applications for and obtain

patents, copyrights, and trademarks in the United States and in selected foreign countries where we believe filing for such protection is appropriate. We also seek to maintain our trade secrets and confidential information by nondisclosure policies and through the use of appropriate confidentiality agreements. We have obtained a substantial number of patents and trademarks in the United States and in other countries. There can be no assurance, however, that the rights obtained can be successfully enforced against infringing products in every jurisdiction. Although we believe the protection afforded by our patents, copyrights, trademarks, and trade secrets has value, the rapidly changing technology in the networking industry and uncertainties in the legal process make our future success dependent primarily on the innovative skills, technological expertise, and management abilities of our employees rather than on the protection afforded by patent, copyright, trademark, and trade secret laws.

Many of our products are designed to include software or other intellectual property licensed from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of our products, we believe, based upon past experience and standard industry practice, that such licenses generally could be obtained on commercially reasonable terms. Nonetheless, there can be no assurance that the necessary licenses would be available on acceptable terms, if at all. Our inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could have a material adverse effect on our business, operating results, and financial condition. Moreover, inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis can limit our ability to protect our proprietary rights in our products.

The industry in which we compete is characterized by rapidly changing technology, a large number of patents, and frequent claims and related litigation regarding patent and other intellectual property rights. There can be no assurance that our patents and other proprietary rights will not be challenged, invalidated, or circumvented; that others will not assert intellectual property rights to technologies that are relevant to us; or that our rights will give us a competitive advantage. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as the laws of the United States. The risks associated with patents and intellectual property are more fully discussed in the section of this report entitled *Risk Factors*, including the risk factors entitled *Our proprietary rights may prove difficult to enforce*, *We may be found to infringe on intellectual property rights of others*, and *We rely on the availability of third-party licenses*.

Employees

As of July 30, 2005, we employed 38,413 employees, including 6,812 in manufacturing and service, 13,935 in engineering, 14,414 in sales and marketing, and 3,252 in finance and administration. Approximately 11,000 employees are in locations outside the United States. We consider the relationships with our employees to be positive. Competition for technical personnel in the industry in which we compete is intense. We believe that our future success depends in part on our continued ability to hire, assimilate, and retain qualified personnel. To date, we believe that we have been successful in recruiting qualified employees, but there is no assurance that we will continue to be successful in the future.

Risk Factors

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this report.

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

Our operating results have been in the past, and will continue to be, subject to quarterly and annual fluctuations as a result of numerous factors. These factors include:

Fluctuations in demand for our products and services, especially with respect to Internet businesses and telecommunications service providers, in part due to the changing global economic environment

Changes in sales and implementation cycles for our products and reduced visibility into our customers' spending plans and associated revenue

Our ability to maintain appropriate inventory levels and purchase commitments

Price and product competition in the communications and networking industries, which can change rapidly due to technological innovation

The overall movement toward industry consolidation among both our competitors and our customers

The introduction and market acceptance of new technologies and products and our success in new markets, including advanced technologies, as well as the adoption of new networking standards

Variations in sales channels, product costs, or mix of products sold

The timing, size, and mix of orders from customers

Manufacturing and customer lead times

Fluctuations in our gross margins, and the factors that contribute to this as described below

Our ability to achieve targeted cost reductions

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

The ability of our customers, channel partners, and suppliers to obtain financing or to fund capital expenditures

The timing and amount of employer payroll tax to be paid on our employees' gains on stock options exercised

Actual events, circumstances, outcomes, and amounts differing from judgments, assumptions, and estimates used in determining the values of certain assets (including the amounts of related valuation allowances), liabilities, and other items reflected in our Consolidated Financial Statements

How well we execute on our strategy and operating plans

Benefits anticipated from our investments in engineering and sales activities

Changes in accounting rules, such as recording expenses for employee stock option grants and changes in tax accounting principles

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

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

Economic conditions worldwide have contributed to slowdowns in the communications and networking industries and may impact our business, resulting in:

Reduced demand for our products as a result of continued constraints on information technology-related capital spending by our customers, particularly service providers

Increased price competition for our products, not only from our competitors but also as a consequence of customers disposing of unutilized products

Risk of excess and obsolete inventories

Excess facilities and manufacturing capacity

Higher overhead costs as a percentage of revenue

Recent turmoil in the geopolitical environment in many parts of the world, including terrorist activities and military actions, particularly the continuing tension in and surrounding Iraq, and changes in energy costs may continue to put pressure on global economic conditions. If the economic and market conditions in the United States and globally do not improve, or if they deteriorate, we may experience material impacts on our business, operating results, and financial condition.

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

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

In addition, to improve customer satisfaction, we continue to attempt to improve our manufacturing lead-time performance, which may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net sales and operating results. Long manufacturing lead times have caused our customers in the past to place the same order multiple times within our various sales channels and to cancel the duplicative orders upon receipt of the product, or to place orders with other vendors with shorter manufacturing lead times. Such multiple ordering (along with other factors) may cause difficulty in predicting our sales and, as a result, could impair our ability to manage parts inventory effectively.

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

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

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

Our recent level of product gross margins may not be sustainable and may continue to be adversely affected by numerous factors, including:

Changes in customer, geographic, or product mix, including mix of configurations within each product group

Introduction of new products, including products with price-performance advantages

Our ability to reduce production costs

Entry into new markets, including markets with different pricing and cost structures

Sales discounts

Increases in material or labor costs

Excess inventory and inventory holding charges

Obsolescence charges

Changes in shipment volume

Loss of cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand

Lower than expected benefits from value engineering

Increased price competition, including competitors from Asia, especially China

Changes in distribution channels

Increased warranty costs

How well we execute on our strategy and operating plans

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

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

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

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

A substantial portion of our products and services is sold through our channel partners and the remainder is sold through direct sales. Our channel partners include systems integrators, service providers, other resellers, distributors, and retail partners. Systems integrators and service providers typically sell directly to end-users and often provide system installation, technical support, professional services, and other support services in addition to network equipment sales. Systems integrators also typically integrate our products into an overall solution, and a number of service providers are also systems integrators. Distributors stock inventory and typically sell to systems integrators, service providers, and other resellers. In addition, with the acquisition of the Linksys business, home networking products are generally sold through distributors and retail partners. We refer to sales through distributors and retail partners as our two-tier system of sales to the end customer. Revenue from distributors and retail partners is recognized based on a sell-through method using information provided by them. These distributors and retail partners are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing

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

Historically, we have seen fluctuations in our gross margins based on changes in the balance of our distribution channels. Although variability to date has not been significant, there can be no assurance that changes in the balance of our distribution model in future periods would not have an adverse effect on our gross margins and profitability.

Some factors could result in disruption of or changes in our distribution model, which could harm our sales and margins, including the following:

We compete with some of our channel partners through our direct sales, which may lead these channel partners to use other suppliers that do not directly sell their own products

Some of our channel partners may demand that we absorb a greater share of the risks that their customers may ask them to bear

Some of our channel partners may have insufficient financial resources and may not be able to withstand changes in business conditions

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

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

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

Sales to the service provider market have been characterized by large and often sporadic purchases, especially relating to our router sales and sales of certain of our advanced technologies, in addition to longer sales cycles. We have experienced significant weakness in sales to service providers as market conditions have changed. Sales activity in this industry depends upon the stage of completion of expanding network infrastructures; the availability of funding; and the extent to which service providers are affected by regulatory, economic, and business conditions in the country of operations. Although some service providers may be increasing capital expenditures over the depressed levels that have prevailed over the last few years, weakness in orders from this industry could have a material adverse effect on our business, operating results, and financial condition. Slowdowns in the general economy, overcapacity, changes in the service provider market, regulatory developments and constraints on capital availability have had a material adverse effect on many of our service provider customers, with many of

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

these customers going out of business or substantially reducing their expansion plans. These conditions have materially harmed our business and operating results, and we expect that some or all of these conditions may continue for the foreseeable future. Finally, service provider customers typically have

longer implementation cycles; require a broader range of service including design services; demand that vendors take on a larger share of risks; often require acceptance provisions, which can lead to a delay in revenue recognition; and expect financing from vendors. All these factors can add further risk to business conducted with service providers.

A SHORTAGE OF ADEQUATE COMPONENT SUPPLY OR MANUFACTURING CAPACITY COULD INCREASE OUR COSTS OR CAUSE A DELAY IN OUR ABILITY TO FULFILL ORDERS, AND OUR FAILURE TO ESTIMATE CUSTOMER DEMAND PROPERLY MAY RESULT IN EXCESS OR OBSOLETE COMPONENT SUPPLY, WHICH COULD ADVERSELY AFFECT OUR GROSS MARGINS

Our growth and ability to meet customer demands depend in part on our ability to obtain timely deliveries of parts from our suppliers and contract manufacturers. We have experienced component shortages in the past, including shortages caused by manufacturing process issues, that have affected our operations. We may in the future experience a shortage of certain component parts as a result of our own manufacturing issues, manufacturing issues at our suppliers or contract manufacturers, capacity problems experienced by our suppliers or contract manufacturers, or strong demand in the industry for those parts, especially if the economy grows. Growth in the economy is likely to create greater pressures on us and our suppliers to accurately project overall component demand and component demands within specific product categories and to establish optimal component levels. If shortages or delays persist, the price of these components may increase, or the components may not be available at all, and we may also encounter shortages if we do not accurately anticipate our needs. We may not be able to secure enough components at reasonable prices or of acceptable quality to build new products in a timely manner in the quantities or configurations needed. Accordingly, our revenue and gross margins could suffer until other sources can be developed. Our operating results would also be adversely affected if, anticipating greater demand than actually develops, we commit to the purchase of more components than we need. There can be no assurance that we will not encounter these problems in the future. Although in many cases we use standard parts and components for our products, certain components are presently available only from a single source or limited sources. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

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

New markets in which we participate may grow quickly, which may make it difficult to quickly obtain significant component capacity

As we acquire companies and new technologies, we may be dependent, at least initially, on unfamiliar supply chains or relatively small supply partners

We face competition for certain components, which are supply-constrained, from existing competitors and companies in other markets

Manufacturing capacity and component supply constraints could be significant issues for us. We purchase components from a variety of suppliers and use several contract manufacturers to provide manufacturing services for our products. During the normal course of business, in order to improve manufacturing lead time performance and to help assure adequate component supply, we enter into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by us or that establish the parameters defining our requirements. In certain instances, these agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed. If we fail to anticipate customer demand properly, an oversupply of parts could result in excess or obsolete components that could adversely affect our gross margins. For additional information regarding our purchase commitments, see Note 8 to the Consolidated Financial Statements in our 2005 Annual Report to Shareholders. A reduction or interruption in supply; a significant increase in the price of one or more components; a failure to adequately authorize procurement of inventory by our contract manufacturers; a failure to appropriately cancel, reschedule, or adjust our requirements based on our business needs; or a decrease in demand for products could materially

adversely affect our business, operating results, and financial condition and could materially damage customer relationships. Furthermore, as a result of binding price or purchase commitments with suppliers, we may be obligated to purchase components at prices that are higher than those available in the current market. In the event that we become committed to purchase components at prices in excess of the current market price when the components are actually used, our gross margins could decrease.

The fact that we do not own the bulk of our manufacturing facilities could have an adverse impact on the supply of our products and on operating results. Financial problems of contract manufacturers on whom we rely, or reservation of manufacturing capacity by other companies, inside or outside of our industry, could either limit supply or increase costs.

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

For information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled Competition contained in Item 1 of this report.

WE DEPEND UPON THE DEVELOPMENT OF NEW PRODUCTS AND ENHANCEMENTS TO EXISTING PRODUCTS, AND IF WE FAIL TO PREDICT AND RESPOND TO EMERGING TECHNOLOGICAL TRENDS AND CUSTOMERS' CHANGING NEEDS, OUR OPERATING RESULTS AND MARKET SHARE MAY SUFFER

The markets for our products are characterized by rapidly changing technology, evolving industry standards, new product introductions, and evolving methods of building and operating networks. Our operating results depend on our ability to develop and introduce new products into existing and emerging markets and to reduce the production costs of existing products. We believe that the Internet and the various networks associated with it, including corporate intranets, cable, broadband and dialup networks, and voice and video networks will evolve to include embedded resources and the virtualization of applications and services to produce an integrated, intelligent system, or as we refer to it, an Intelligent Information Network. This is our vision for the evolution of networking from connectivity products to intelligent systems. As such, many of our strategic initiatives and investments are aimed at meeting the requirements that an Intelligent Information Network would demand. The process of developing new technology is complex and uncertain, and if we fail to accurately predict customers' changing needs and emerging technological trends, our business could be harmed. We must commit significant resources to developing new products before knowing whether our investments will result in products the market will accept. In particular, if our model of the evolution of networking from connectivity products to intelligent systems does not emerge as we believe it will, many of our strategic initiatives and investments may be of no or limited value. Furthermore, we may not execute successfully on that vision because of errors in product planning or timing, technical hurdles that we fail to overcome in a timely fashion, or a lack of appropriate resources. This could result in competitors providing those solutions before we do and loss of market share, net sales and earnings. The success of new products depends on several factors, including proper new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, or achieve market acceptance of our products or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive. Specifically, the products and technologies that we identify as advanced technologies may not prove to have the market success we anticipate, and we may not successfully identify and invest in other advanced technologies.

WE ARE INCREASING OUR INVESTMENT IN ENGINEERING AND SALES ACTIVITIES AND THESE INVESTMENTS MAY ACHIEVE DELAYED, OR LOWER THAN EXPECTED, BENEFITS WHICH COULD HARM OUR OPERATING RESULTS

We intend to continue to add personnel and other resources to both our engineering and sales functions as we focus on developing the next wave of advanced technologies, growing the commercial market segment, capitalizing on our emerging market opportunities, and increasing our market share gains. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits, and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

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

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

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

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

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions. Additionally, we are required to perform goodwill impairment tests on an annual basis and between annual tests in certain circumstances, and future goodwill impairment tests may result in a charge to earnings.

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

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

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

Difficulties in integrating the operations, technologies, products, and personnel of the acquired companies

Diversion of management's attention from normal daily operations of the business

Potential difficulties in completing projects associated with in-process research and development

Difficulties in entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions

Initial dependence on unfamiliar supply chains or relatively small supply partners

Insufficient revenue to offset increased expenses associated with acquisitions

The potential loss of key employees of the acquired companies

Acquisitions may also cause us to:

Issue common stock that would dilute our current shareholders' percentage ownership

Assume liabilities

Record goodwill and nonamortizable intangible assets that will be subject to impairment testing on a regular basis and potential periodic impairment charges

Incur amortization expenses related to certain intangible assets

Incur large and immediate write-offs and restructuring and other related expenses

Become subject to intellectual property or other litigation

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

From time to time, we have made acquisitions that resulted in in-process research and development expenses being charged in an individual quarter. These charges may occur in any particular quarter, resulting in variability in our quarterly earnings. Risks related to new product development also apply to acquisitions. Please see the risk factor above entitled "We depend upon the development of new products and enhancements to existing products, and if we fail to predict and respond to emerging technological trends and customers' changing needs, our operating results and market share may suffer" for additional information.

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

As we focus on new market opportunities for example, storage; wireless; security; and transporting data, voice, and video traffic across the same network we will increasingly compete with large telecommunications equipment suppliers as well as startup companies. Several of our competitors may have greater resources, including technical and engineering resources, than we do. Additionally, as customers in these markets complete infrastructure deployments, they may require greater levels of service, support, and financing than we have provided in the past. Demand for these types of service or financing contracts may increase in the future. There can be no assurance that we can provide products, service, support, and financing to effectively compete for these market opportunities. Further, provision of greater levels of services by us may result in a delay in the timing of revenue recognition. In addition, entry into other markets, including our recent entry into the consumer market, has subjected and will subject us to additional risks, particularly to those markets, including the effects of general market conditions and reduced consumer confidence.

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

We produce highly complex products that incorporate leading-edge technology, including both hardware and software. Software typically contains bugs that can unexpectedly interfere with expected operations. There can be no assurance that our preshipment testing programs will be adequate to detect all defects, either ones in individual products or ones that could affect numerous shipments, which might interfere with customer satisfaction, reduce sales opportunities, or affect gross margins. In the past, we have had to replace certain components and provide remediation in response to the discovery of defects or bugs in products that we had shipped. Although the cost of such remediation has not been material in the past, there can be no assurance that such a remediation, depending on the product involved, would not have a material impact. An inability to cure a product defect could result in the failure of a product line, temporary or permanent withdrawal from a product or market, damage to our reputation, inventory costs, or product reengineering expenses, any of which could have a material impact on revenue, margins, and net income.

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

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. We believe that industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in operating results and could have a material adverse effect on our business, operating results, and financial condition. Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

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

We conduct significant sales and customer support operations in countries outside of the United States and also depend on non-U.S. operations of our contract manufacturers and our distribution partners. For fiscal 2005 and fiscal 2004, we derived 48.8% and 49.3% of our net sales, respectively, from sales outside the United States. Accordingly, our future results could be materially adversely affected by a variety of uncontrollable and changing factors, including, among others, foreign currency exchange rates; political or social unrest, economic instability or natural disasters in a specific country or region; environmental and trade protection measures and other regulatory requirements, which may affect our ability to import our products to, export our products from, or sell our products in various countries; political considerations that affect service provider and government spending patterns; health or similar issues, such as the outbreak of Severe Acute Respiratory Syndrome (SARS) in Asia; difficulties in staffing and managing international operations; and adverse tax consequences, including imposition of withholding or other taxes on payments by subsidiaries. Any or all of these factors could have a material adverse impact on our costs, expenses, and financial condition.

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

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve, and they could have a material adverse impact on our financial results and cash flows. Historically, our primary exposures have related to nondollar-denominated sales in Japan, Canada, and Australia and certain nondollar-denominated operating expenses in Europe, Latin America, and Asia, where we sell primarily in U.S. dollars. Additionally, we have exposures to emerging market currencies, which can have

extreme currency volatility. An increase in the value of the dollar could increase the real cost to our customers of our products in those markets outside the United States where we sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement of raw materials to the extent that we must purchase components in foreign currencies.

Currently, we enter into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on certain foreign currency receivables, investments, and payables. In addition, we periodically hedge anticipated foreign currency cash flows. Our attempts to hedge against these risks may not be successful, resulting in an adverse impact on our net income.

WE ARE EXPOSED TO THE CREDIT RISK OF SOME OF OUR CUSTOMERS AND TO CREDIT EXPOSURES IN WEAKENED MARKETS, WHICH COULD RESULT IN MATERIAL LOSSES

Most of our sales are on an open credit basis, with typical payment terms of 30 days in the United States and, because of local customs or conditions, longer in some markets outside the United States. We monitor individual customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts. Beyond our open credit arrangements, we have also experienced demands for customer financing and facilitation of leasing arrangements. We expect demand for customer financing to continue. We believe customer financing is a competitive factor in obtaining business, particularly in supplying customers involved in significant infrastructure projects. Our loan financing arrangements may include not only financing the acquisition of our products and services but also providing additional funds for other costs associated with network installation and integration of our products and services and for working capital purposes. We do not recognize revenue on structured loan financing arrangements until cash payments are received.

Our exposure to the credit risks relating to our financing activities described above may increase if there is an economic slowdown. Although we have programs in place that are designed to monitor and mitigate the associated risk, including monitoring of particular risks in certain geographic areas, there can be no assurance that such programs will be effective in reducing our credit risks. There have been significant bankruptcies among customers both on open credit and with loan or lease financing arrangements, particularly among Internet businesses and service providers, causing us to incur economic or financial losses. There can be no assurance that additional losses will not be incurred. Although these losses have not been material to date, future losses, if incurred, could harm our business and have a material adverse effect on our operating results and financial condition. A portion of our sales is derived through our distributors and retail partners. These distributors and retail partners are generally given business terms that allow them to return a portion of inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. We maintain estimated accruals and allowances for such business terms. However, distributors tend to have more limited financial resources than other resellers and end-user customers and therefore represent potential sources of increased credit risk because they may be more likely to lack the reserve resources to meet payment obligations.

OUR PROPRIETARY RIGHTS MAY PROVE DIFFICULT TO ENFORCE

We generally rely on patents, copyrights, trademarks, and trade secret laws to establish and maintain proprietary rights in our technology and products. Although we have been issued numerous patents and other patent applications are currently pending, there can be no assurance that any of these patents or other proprietary rights will not be challenged, invalidated, or circumvented or that our rights will, in fact, provide competitive advantages to us. Furthermore, many key aspects of networking technology are governed by industrywide standards, which are usable by all market entrants. In addition, there can be no assurance that patents will be issued from pending applications or that claims allowed on any patents will be sufficiently broad to protect our technology. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as do the laws of the United States. The outcome of any actions taken in these foreign countries may be different than if such actions were determined under the laws of the United States. Although we are not

dependent on any individual patents or group of patents for particular segments of the business for which we compete, if we are unable to protect our proprietary rights to the totality of the features (including aspects of products protected other than by patent rights) in a market, we may find ourselves at a competitive disadvantage to others who need not incur the substantial expense, time, and effort required to create the innovative products that have enabled us to be successful.

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

Third parties, including customers, have in the past and may in the future assert claims or initiate litigation related to exclusive patent, copyright, trademark, and other intellectual property rights to technologies and related standards that are relevant to us. These assertions have increased over time as a result of our growth and the general increase in the pace of patent claims assertions, particularly in the United States. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents, and the rapid rate of issuance of new patents, it is not economically practical or even possible to determine in advance whether a product or any of its components infringes or will infringe on the patent rights of others. The asserted claims and/or initiated litigation can include claims against us or our manufacturers, suppliers, or customers, alleging infringement of their proprietary rights with respect to our existing or future products or components of those products. Regardless of the merit of these claims, they can be time-consuming, result in costly litigation and diversion of technical and management personnel, or require us to develop a non-infringing technology or enter into license agreements. Where claims are made by customers, resistance even to unmeritorious claims could damage customer relationships. There can be no assurance that licenses will be available on acceptable terms and conditions, if at all, or that our indemnification by our suppliers will be adequate to cover our costs if a claim were brought directly against us or our customers. Furthermore, because of the potential for high court awards that are not necessarily predictable, it is not unusual to find even arguably unmeritorious claims settled for significant amounts. If any infringement or other intellectual property claim made against us by any third party is successful, or if we fail to develop non-infringing technology or license the proprietary rights on commercially reasonable terms and conditions, our business, operating results, and financial condition could be materially and adversely affected.

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

WE RELY ON THE AVAILABILITY OF THIRD-PARTY LICENSES

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

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

Currently, few laws or regulations apply directly to access or commerce on the Internet. We could be materially adversely affected by regulation of the Internet and Internet commerce in any country where we operate. Such regulations could include matters such as voice over the Internet or using IP, encryption

technology, sales taxes on Internet product sales, and access charges for Internet service providers. The adoption of regulation of the Internet and Internet commerce could decrease demand for our products and, at the same time, increase the cost of selling our products, which could have a material adverse effect on our business, operating results, and financial condition.

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

Changes in telecommunications requirements in the United States or other countries could affect the sales of our products. In particular, we believe that there may be future changes in U.S. telecommunications regulations that could slow the expansion of the service providers' network infrastructures and materially adversely affect our business, operating results, and financial condition. Future changes in tariffs by regulatory agencies or application of tariff requirements to currently untariffed services could affect the sales of our products for certain classes of customers. Additionally, in the United States, our products must comply with various Federal Communications Commission requirements and regulations. In countries outside of the United States, our products must meet various requirements of local telecommunications authorities. Changes in tariffs or failure by us to obtain timely approval of products could have a material adverse effect on our business, operating results, and financial condition.

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

Our success has always depended in large part on our ability to attract and retain highly skilled technical, managerial, sales, and marketing personnel. Competition for these personnel is intense, especially in the Silicon Valley area of Northern California. Stock option grants are designed to reward employees for their long-term contributions and provide incentives for them to remain with us. Volatility, lack of positive performance in our stock price or changes to our overall compensation program, including our stock incentive program, may also adversely affect our ability to retain key employees, virtually all of whom have been granted stock options. The loss of services of any of our key personnel, the inability to retain and attract qualified personnel in the future, or delays in hiring required personnel, particularly engineering and sales personnel, could make it difficult to meet key objectives, such as timely and effective product introductions. In addition, companies in the networking industry whose employees accept positions with competitors frequently claim that competitors have engaged in improper hiring practices. We have received these claims in the past and may receive additional claims to this effect in the future.

ADVERSE RESOLUTION OF LITIGATION MAY HARM OUR OPERATING RESULTS OR FINANCIAL CONDITION

We are a party to lawsuits in the normal course of our business. Litigation can be expensive, lengthy, and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit could have a material adverse effect on our business, operating results, or financial condition. For additional information regarding certain of the lawsuits in which we are involved, see Item 3, Legal Proceedings, contained in Part I of this report.

CHANGES IN EFFECTIVE TAX RATES OR ADVERSE OUTCOMES RESULTING FROM EXAMINATION OF OUR INCOME TAX RETURNS COULD ADVERSELY AFFECT OUR RESULTS

Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and higher than anticipated in countries where we have higher statutory rates, by changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws, regulations, accounting principles or interpretations thereof. In addition, we are subject to the continuous

examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition.

In July 2005, the FASB issued an Exposure Draft of a proposed Interpretation Accounting for Uncertain Tax Positions an interpretation of FASB Statement No. 109. The proposed Interpretation proposes changes to the current accounting for uncertain tax positions. While we cannot predict with certainty the rules in the final Interpretation, there is risk that the final Interpretation could result in a cumulative effect charge to earnings upon adoption, increases in future effective tax rates, and/or increases in future interperiod effective tax rate volatility.

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

Our corporate headquarters, including certain of our research and development operations and our manufacturing facilities, are located in the Silicon Valley area of Northern California, a region known for seismic activity. Additionally, a certain number of our facilities, including one of our manufacturing facilities, are located near rivers that have experienced flooding in the past. A significant natural disaster, such as an earthquake or a flood, could have a material adverse impact on our business, operating results, and financial condition.

MANMADE PROBLEMS SUCH AS COMPUTER VIRUSES OR TERRORISM MAY DISRUPT OUR OPERATIONS AND HARM OUR OPERATING RESULTS

Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems. Any such event could have a material adverse effect on our business, operating results, and financial condition. Efforts to limit the ability of malicious third parties to disrupt the operations of the Internet or undermine our own security efforts may meet with resistance. In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the U.S. and other countries and create further uncertainties or otherwise materially harm our business, operating results, and financial condition. Similarly, events such as widespread blackouts could have similar negative impacts. To the extent that such disruptions or uncertainties result in delays or cancellations of customer orders or the manufacture or shipment of our products, our business, operating results, and financial condition could be materially and adversely affected.

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

We maintain an investment portfolio of various holdings, types, and maturities. These securities are generally classified as available-for-sale and, consequently, are recorded on the Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax. Part of this portfolio includes equity investments in publicly traded companies, the values of which are subject to market price volatility to the extent unhedged. If there is an economic slowdown which adversely affects the public equities market, we may recognize in earnings the decline in fair value of our publicly traded equity investments below the cost basis when the decline is judged to be other-than-temporary. For information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, refer to the section titled Quantitative and Qualitative Disclosures About Market Risk included in our 2005 Annual Report to Shareholders, which section is incorporated by reference into this report. Our investments in private companies are subject to risk of loss of investment capital. These investments are inherently risky because the markets for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose our entire investment in these companies.

IF WE DO NOT SUCCESSFULLY MANAGE OUR STRATEGIC ALLIANCES, WE MAY EXPERIENCE INCREASED COMPETITION OR DELAYS IN PRODUCT DEVELOPMENT

We have several strategic alliances with large and complex organizations and other companies with whom we work to offer complementary products and services. These arrangements are generally limited to specific projects, the goal of which is generally to facilitate product compatibility and adoption of industry standards. If successful, these relationships may be mutually beneficial and result in industry growth. However, these alliances carry an element of risk because, in most cases, we must compete in some business areas with a company with which we have a strategic alliance and, at the same time, cooperate with that company in other business areas. Also, if these companies fail to perform or if these relationships fail to materialize as expected, we could suffer delays in product development or other operational difficulties.

OUR STOCK PRICE MAY CONTINUE TO BE VOLATILE

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

Executive Officers of the Registrant

The following table shows the name, age and position of each of our executive officers as of August 31, 2005:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|-----------------|------------|--|
| Larry R. Carter | 62 | Senior Vice President, Office of the President, and Director |

Mr. Carter has been a member of the Board of Directors since July 2000. He joined Cisco in January 1995 as Vice President of Finance and Administration, Chief Financial Officer, and Secretary. In July 1997, he was promoted to Senior Vice President of Finance and Administration, Chief Financial Officer, and Secretary. In May 2003, upon his retirement as Chief Financial Officer and Secretary, he was appointed to his current position. Before joining Cisco, he was employed by Advanced Micro Devices, Inc. as Vice President and Corporate Controller. Mr. Carter also currently serves on the board of directors of QLogic Corporation.

| | | |
|------------------|----|--|
| John T. Chambers | 56 | President, Chief Executive Officer, and Director |
|------------------|----|--|

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

Mr. Chambers has been a member of the Board of Directors since November 1993. He joined Cisco as Senior Vice President in January 1991 and was promoted to Executive Vice President in June 1994. Mr. Chambers was promoted to his current position as of January 31, 1995. Before joining Cisco, he was employed by Wang Laboratories, Inc. for eight years, where, in his last role, he was the Senior Vice President of U.S. Operations.

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|---------------|------------|---|
| Mark Chandler | 49 | Vice President, Legal Services, General Counsel and Secretary |

Mr. Chandler joined Cisco in July 1996, upon Cisco's acquisition of StrataCom, Inc., where he served as General Counsel. He served as Cisco's Managing Attorney for Europe, the Middle East, and Africa from December 1996 until June 1999, as Director, Worldwide Legal Operations from June 1999 until February 2001, and was promoted to Vice President, Worldwide Legal Services in February 2001. In October 2001, he was promoted to Vice President, Legal Services and General Counsel. In May 2003, he was also appointed Secretary. Before joining StrataCom, he had served as Vice President, Corporate Development and General Counsel of Maxtor Corporation.

| | | |
|----------------------|----|--|
| Charles H. Giancarlo | 47 | Senior Vice President, Chief Development Officer |
|----------------------|----|--|

Mr. Giancarlo joined Cisco in December 1994 as Director of Business Development. He was promoted to Vice President in September 1995. He was Vice President of Global Alliances from April 1997 to April 1999 and promoted to Senior Vice President in April 1998. In April 1999, he was promoted to Senior Vice President, Commercial Line of Business. In August 2001, he was promoted to Senior Vice President and General Manager of the Access, Aggregation, Ethernet Switching, and Wireless Groups. In May 2002, he was promoted to Senior Vice President of the Switching, Voice and Storage Groups. In June 2003, he also became the President of Cisco-Linksys LLC. In August 2004, he was promoted to Chief Technology Officer. At the end of July 2005, he was promoted to his current position, and he currently co-chairs the Cisco Enterprise Business Council and serves as President of Cisco-Linksys LLC. Before joining Cisco, he served as Vice President of Marketing with Kalpana Corporation from July 1993 until Kalpana was acquired by Cisco in December 1994.

| | | |
|--------------------|----|---|
| Richard J. Justice | 55 | Senior Vice President, Worldwide Field Operations |
|--------------------|----|---|

Mr. Justice joined Cisco in December 1996 as Senior Vice President of the Americas. In February 2000, he was promoted to his current position. Before joining Cisco, Mr. Justice spent 22 years at Hewlett-Packard Company where, in his last role, he was responsible for Worldwide Enterprise Sales and Marketing.

| | | |
|------------|----|---|
| Randy Pond | 51 | Senior Vice President, Operations, Processes, and Systems |
|------------|----|---|

Mr. Pond joined Cisco in September 1993. In 1994, Mr. Pond assumed leadership of Cisco's Supply/Demand group. In 1994, he was appointed Director of Manufacturing Operations. He was promoted to Vice President of Manufacturing in 1995. In January 2000, Mr. Pond was promoted to Senior Vice President of West Coast and Asia operations. He was promoted to Senior Vice President, Worldwide Manufacturing Operations and Logistics in June 2001. In August 2003, he was promoted to his current position. Before joining Cisco, Mr. Pond held the position of Vice President Finance, Chief Financial Officer and Vice President of Operations at Crescendo Communications, Inc. until Crescendo was acquired by Cisco in September 1993.

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|------------------|------------|---|
| Dennis D. Powell | 57 | Senior Vice President and Chief Financial Officer |

Mr. Powell joined Cisco in January 1997 as Vice President, Corporate Controller. In June 2002, he was promoted to Senior Vice President, Corporate Finance. Mr. Powell was promoted to Senior Vice President and Chief Financial Officer in May 2003. Before joining Cisco, Mr. Powell was employed by Coopers & Lybrand LLP for 26 years, most recently as a senior partner. Mr. Powell currently serves on the board of directors of Intuit Inc.

| | | |
|--------------|----|---|
| Betsy Rafael | 44 | Vice President, Corporate Controller and Principal Accounting Officer |
|--------------|----|---|

Ms. Rafael joined Cisco in April 2002 as Vice President, Corporate Controller. In July 2003 she was also named to the role of Principal Accounting Officer. Before joining Cisco, from December 2000 until March 2002, Ms. Rafael was employed by Aspect Communications Corporation, most recently as Executive Vice President, Finance, Chief Financial Officer and Chief Administrative Officer. From May 2000 until November 2000, she was employed by Escalate Corporation as Senior Vice President and Chief Financial Officer. From November 1994 until May 2000, she was employed by Silicon Graphics, Inc., most recently as Senior Vice President and Chief Financial Officer. Ms. Rafael currently serves on the board of directors of PalmSource, Inc.

| | | |
|------------------|----|--|
| James Richardson | 48 | Senior Vice President, Chief Marketing Officer |
|------------------|----|--|

Mr. Richardson joined Cisco in May 1990, founded Cisco's Canadian operations, and was promoted to Vice President of Intercontinental Operations in June 1992. Mr. Richardson was promoted to Vice President of North American Operations in June 1994. He was promoted to President of EMEA and Senior Vice President in August 1996. In September 1999, he was promoted to Senior Vice President, Office of the President. In January 2000, he was promoted to Senior Vice President of the Enterprise Line of Business and Internet Communications Software Group. In August 2001, Mr. Richardson was promoted to his current position.

ITEM 2. Properties

Our headquarters are located on an owned site in San Jose, California. In addition to this site, we own certain sites in the United States, which include facilities in the surrounding areas of San Jose, California; Boxborough, Massachusetts; Salem, New Hampshire; Richardson, Texas; and Research Triangle Park, North Carolina. We also own land for expansion in some of these locations. In addition, we also lease office space in several U.S. locations.

Outside the United States, we have operations, primarily in leased sites, in the Americas, EMEA, Asia Pacific, and Japan. Larger site locations include the United Kingdom, France, Belgium, the Netherlands, Singapore, Hong Kong, Australia, Japan, and India. We own and lease manufacturing facilities, which are primarily test and assembly operations, in two locations in the United States and none internationally. We believe that our existing properties, including both owned and leased sites, are in good condition and suitable for the conduct of our business.

For additional information regarding obligations under leases, see Note 8 to the Consolidated Financial Statements in our 2005 Annual Report to Shareholders, which is incorporated by reference herein. For additional information regarding properties by operating segment, see Note 12 to

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

the Consolidated Financial Statements in our 2005 Annual Report to Shareholders, which is incorporated by reference herein.

ITEM 3. Legal Proceedings

Beginning on April 20, 2001, a number of purported shareholder class action lawsuits were filed in the United States District Court for the Northern District of California against Cisco and certain of our officers and directors. The lawsuits have been consolidated, and the consolidated action is purportedly brought on behalf of those who purchased our publicly traded securities between August 10, 1999 and February 6, 2001. Plaintiffs allege that defendants have made false and misleading statements, purport to assert claims for violations of the federal securities laws, and seek unspecified compensatory damages and other relief. We believe the claims are without merit and intend to defend the actions vigorously. While we believe there is no legal basis for liability, due to the uncertainty surrounding the litigation process, we are unable to reasonably estimate a range of loss, if any, at this time.

Beginning on April 23, 2001, a number of purported shareholder derivative lawsuits were filed in the Superior Court of California, County of Santa Clara, in the Superior Court of California, County of San Mateo and in the United States District Court for the Northern District of California. These actions were later consolidated. The complaints included claims for breach of fiduciary duty, waste of corporate assets, mismanagement, unjust enrichment, and violations of the California Corporations Code; sought compensatory damages, disgorgement, and other relief; and were based on essentially the same allegations as the class actions. On March 22, 2005, the Superior Court approved a comprehensive settlement of all of these derivative claims, which provided for dismissal with prejudice of all of plaintiffs' claims, reimbursement of a portion of plaintiffs' attorneys' fees and agreement to maintain certain of our policies and consider others.

On February 16, 2005, a purported shareholder derivative lawsuit was filed in the Superior Court of California, County of Santa Clara, against various of our officers and directors and naming us as a nominal defendant. The lawsuit includes claims for breach of fiduciary duty, unjust enrichment, constructive trust and violations of the California Corporations Code, is based upon allegations of wrongdoing in connection with option grants and compensation to officers and directors, the timing of option grants, and our share repurchase plan, and seeks unspecified compensation and other damages, rescission of options and other relief.

In addition, we were subject to patent claims asserted by Storage Technology Corporation against us on December 10, 1999. Claims related to one patent were dismissed, and a trial relating to claims related to a second patent commenced May 19, 2005 in the Federal District Court for the Northern District of California. The claims which were the subject of the trial included an assertion that NetFlow Feature Acceleration infringed United States Patent No. 5,842,040, and included demands for damages and injunctive relief. On June 7, 2005, the court entered judgment in our favor when the jury returned a verdict finding no infringement by us and that the patent claims at issue in the case were invalid.

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

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

(a) On May 20, 2005, we issued an aggregate of 1,595,984 shares of our common stock in connection with the acquisition of Vihana, Inc. The offer and sale of the securities were effected without registration in reliance on the exemption afforded by Section 3(a)(10) of the Securities Act of 1933, as amended. The issuance was approved, after a hearing upon the fairness of the terms and conditions of the transaction, by the California Department of Corporations.

The remainder of the information required by this item is incorporated by reference to page 71 of our 2005 Annual Report to Shareholders.

(b) None.

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

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs(1) | Approximate Dollar Value of Shares That May Yet Be Purchased under the Plans or Programs(1) |
|--------------------------------|---|------------------------------------|--|--|
| | | | | |
| May 1, 2005 to May 28, 2005 | 43 | \$ 18.57 | 43 | \$ 9,542 |
| May 29, 2005 to June 25, 2005 | 39 | \$ 19.53 | 39 | \$ 8,772 |
| June 26, 2005 to July 30, 2005 | 48 | \$ 19.35 | 48 | \$ 7,847 |
| Total | 130 | \$ 19.14 | 130 | |

(1) In September 2001, our Board of Directors authorized a stock repurchase program. As of July 30, 2005, our Board of Directors has authorized the repurchase of up to \$35 billion of common stock under this program. During fiscal 2005, we repurchased and retired 540 million shares of our common stock at an average price of \$18.95 per share for an aggregate purchase price of \$10.2 billion. As of July 30, 2005, we had repurchased and retired 1.5 billion shares of our common stock at an average price of \$18.15 per share for an aggregate purchase price of \$27.2 billion since inception of the stock repurchase program, and the remaining authorized amount for stock repurchases under this program was \$7.8 billion with no termination date.

ITEM 6. Selected Financial Data

The information required by this item is incorporated by reference to page 18 of our 2005 Annual Report to Shareholders.

ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information required by this item is incorporated by reference to pages 19 to 36 of our 2005 Annual Report to Shareholders.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by this item is incorporated by reference to pages 37 to 39 of our 2005 Annual Report to Shareholders.

ITEM 8. Financial Statements and Supplementary Data

The information required by this item is incorporated by reference to pages 40 to 71 of our 2005 Annual Report to Shareholders.

ITEM 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

ITEM 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Internal Control Over Financial Reporting

Management's report on our internal control over financial reporting and the report of our independent registered public accounting firm are incorporated by reference to the portion of page 16 under the caption "Management's Report on Internal Control Over Financial Reporting" and the portion of page 17 under the caption "Internal Control Over Financial Reporting," respectively, of our 2005 Annual Report to Shareholders.

There was no change in our internal control over financial reporting during our fourth quarter of fiscal 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors and Executive Officers of the Registrant

The information required by this item relating to our directors and nominees, and regarding compliance with Section 16(a) of the Securities Act of 1934, is included under the captions Proposal No. 1: Election of Directors and Ownership of Securities Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement related to the 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

Pursuant to General Instruction G(3) of Form 10-K, the information required by this item relating to our executive officers is included under the caption Executive Officers of the Registrant in Part I of this report.

We have adopted a code of ethics that applies to our principal executive officer and all members of our finance department, including the principal financial officer and principal accounting officer. This code of ethics, which consists of the Special Ethics Obligations for Employees with Financial Reporting Responsibilities section of our Code of Business Conduct that applies to employees generally, is posted on our Website. The Internet address for our Website is www.cisco.com, and the code of ethics may be found from our main Web page by clicking first on About Cisco and then on Corporate Governance under Investor Relations, next on Code of Business Conduct, and finally on Special Ethics Obligations for Employees with Financial Reporting Responsibilities.

We intend to satisfy any disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or waiver from, a provision of this code of ethics by posting such information on our Website, at the address and location specified above.

ITEM 11. Executive Compensation

The information required by this item is included under the captions Proposal No. 1: Election of Directors Director Compensation and Executive Compensation and Related Information in our Proxy Statement related to the 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item relating to security ownership of certain beneficial owners and management is included under the caption Ownership of Securities, and the information required by this item relating to securities authorized for issuance under equity compensation plans is included under the caption Proposal No. 2: Approval of the 2005 Stock Incentive Plan Equity Compensation Plan Information, in each case in our Proxy Statement related to the 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. Certain Relationships and Related Transactions

None.

ITEM 14. Principal Accountant Fees and Services

The information required by this item is included under the captions "Proposal No. 3: Ratification of Independent Registered Public Accounting Firm Principal Accountant Fees and Services" and "Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm" in our Proxy Statement related to the 2005 Annual Meeting of Shareholders and is incorporated herein by reference.

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a) 1. Financial Statements

The Index to Financial Statements and Financial Statement Schedule on page 31 is incorporated herein by reference as the list of financial statements required as part of this report.

2. Financial Statement Schedule

The Index to Financial Statements and Financial Statement Schedule on page 31 is incorporated herein by reference as the list of financial statement schedules required as part of this report.

3. Exhibits

The exhibit list in the Index to Exhibits is incorporated herein by reference as the list of exhibits required as part of this report.

**INDEX TO FINANCIAL STATEMENTS
AND FINANCIAL STATEMENT SCHEDULE**

Item 15(a)

| | <u>Page</u> |
|---|---------------------|
| | 2005 Annual |
| | Report to |
| | Form 10-K |
| | Shareholders |
| Management's Report on Internal Control Over Financial Reporting | 16 |
| Report of Independent Registered Public Accounting Firm | 17 |
| Consolidated Statements of Operations for each of the three years in the period ended July 30, 2005 | 40 |
| Consolidated Balance Sheets at July 30, 2005 and July 31, 2004 | 41 |
| Consolidated Statements of Cash Flows for each of the three years in the period ended July 30, 2005 | 42 |
| Consolidated Statements of Shareholders' Equity for each of the three years in the period ended July 30, 2005 | 43 |
| Notes to Consolidated Financial Statements | 44-70 |
| Supplementary Financial Data (Unaudited) and Stock Market Information | |
| Fiscal 2005 and 2004 by Quarter | 71 |
| Financial Statement Schedule | |
| <u>Schedule II Valuation and Qualifying Accounts</u> | 32 |
| <u>Report of Independent Registered Public Accounting Firm</u> | 33 |

SCHEDULE II

VALUATION AND QUALIFYING ACCOUNTS

(in millions)

| | Allowance for Doubtful Accounts | Allowance for Inventory | Liability for Purchase Commitments |
|--|---------------------------------------|----------------------------|--|
| Year ended July 26, 2003: | | | |
| Balance at beginning of fiscal year | \$ 335 | \$ 226 | \$ 238 |
| (Credited) charged to expenses or other accounts | (59) | 70 | 3 |
| Deductions | (93) | (174) | (142) |
| Balance at end of fiscal year | \$ 183 | \$ 122 | \$ 99 |
| Year ended July 31, 2004: | | | |
| Balance at beginning of fiscal year | \$ 183 | \$ 122 | \$ 99 |
| Charged to expenses or other accounts | 19 | 205 | 46 |
| Deductions | (23) | (188) | (4) |
| Balance at end of fiscal year | \$ 179 | \$ 139 | \$ 141 |
| Year ended July 30, 2005: | | | |
| Balance at beginning of fiscal year | \$ 179 | \$ 139 | \$ 141 |
| Charged to expenses or other accounts | | 221 | 12 |
| Deductions | (17) | (201) | (46) |
| Balance at end of fiscal year | \$ 162 | \$ 159 | \$ 107 |

The liability for purchase commitments is reported as other accrued liabilities on the Consolidated Balance Sheets.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON FINANCIAL STATEMENT SCHEDULE

To the Board of Directors and Shareholders of Cisco Systems, Inc.:

Our audits of the consolidated financial statements referred to in our report dated September 16, 2005 appearing in the 2005 Annual Report to Shareholders of Cisco Systems, Inc. (which report and consolidated financial statements are incorporated by reference in this Annual Report on Form 10-K) also included an audit of the financial statement schedule listed in Item 15(a)(2) of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ PRICEWATERHOUSECOOPERS LLP

San Jose, California

September 16, 2005

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

September 16, 2005

CISCO SYSTEMS, INC.

/s/ JOHN T. CHAMBERS

John T. Chambers

(President and Chief Executive Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John T. Chambers and Dennis D. Powell, jointly and severally, his attorney-in-fact, each with the full power of substitution, for such person, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might do or could do in person hereby ratifying and confirming all that each of said attorneys-in-fact and agents, or his substitute, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report on Form 10-K has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|--|---|--------------------|
| <u>/s/ JOHN T. CHAMBERS</u> John T. Chambers | President and Chief Executive Officer and Director (Principal Executive Officer) | September 16, 2005 |
| <u>/s/ DENNIS D. POWELL</u> Dennis D. Powell | Senior Vice President and Chief Financial Officer (Principal Financial Officer) | September 16, 2005 |
| <u>/s/ BETSY RAFAEL</u> Betsy Rafael | Vice President, Corporate Controller, and Principal Accounting Officer (Principal Accounting Officer) | September 16, 2005 |
| <u>/s/ JOHN P. MORGRIDGE</u> John P. Morgridge | Chairman of the Board and Director | September 16, 2005 |
| <u>Donald T. Valentine</u> Donald T. Valentine | Vice Chairman of the Board and Director | |

Edgar Filing: CISCO SYSTEMS INC - Form 10-K

/s/ CAROL A. BARTZ

Director

September 16, 2005

Carol A. Bartz

/s/ M. MICHELE BURNS

Director

September 16, 2005

M. Michele Burns

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---------------------------------|--------------|--------------------|
| <u>/s/ LARRY R. CARTER</u> | Director | September 16, 2005 |
| Larry R. Carter | | |
| <u>/s/ DR. JAMES F. GIBBONS</u> | Director | September 16, 2005 |
| Dr. James F. Gibbons | | |
| <u>/s/ DR. JOHN L. HENNESSY</u> | Director | September 16, 2005 |
| Dr. John L. Hennessy | | |
| <u>Richard M. Kovacevich</u> | Director | |
| Richard M. Kovacevich | | |
| <u>/s/ RODERICK C. McGEARY</u> | Director | September 16, 2005 |
| Roderick C. McGeary | | |
| <u>/s/ JAMES C. MORGAN</u> | Director | September 16, 2005 |
| James C. Morgan | | |
| <u>/s/ STEVEN M. WEST</u> | Director | September 16, 2005 |
| Steven M. West | | |
| <u>Jerry Yang</u> | Director | |
| Jerry Yang | | |

INDEX TO EXHIBITS

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed |
|---------------------------|---|----------------------------------|-----------------|----------------|--------------------|-----------------|
| | | Form | File No. | Exhibit | Filing Date | Herewith |
| 3.1 | Restated Articles of Incorporation of Cisco Systems, Inc., as currently in effect | S-3 | 333-56004 | 4.1 | 2/21/2001 | |
| 3.2 | Amended and Restated Bylaws of Cisco Systems, Inc., as currently in effect | 10-Q | 000-18225 | 3.2 | 11/17/2003 | |
| 10.1* | Cisco Systems, Inc. Amended and Restated 1996 Stock Incentive Plan (including related form agreements) | 10-K | 000-18225 | 10.1 | 9/20/2004 | |
| 10.2* | 1997 Supplemental Stock Incentive Plan (including related form agreements) | 10-K | 000-18225 | 10.2 | 9/10/2003 | |
| 10.3* | Professional and Leadership Incentive Plan Fiscal Year 2005 | 10-K | 000-18225 | 10.4 | 9/20/2004 | |
| 10.4* | Cisco Systems, Inc. Employee Stock Purchase Plan (including Sub-plan, the International Employee Stock Purchase Plan) | 10-Q | 000-18225 | 10.4 | 11/17/2003 | |
| 10.5* | Notice of Grant of Stock Option and Stock Option Agreement between John T. Chambers and Cisco Systems, Inc. | 10-K | 000-18225 | 10.6 | 9/20/2004 | |
| 10.6* | Form of Officer Indemnification Agreement | 10-K | 000-18225 | 10.7 | 9/20/2004 | |
| 10.7* | Form of Director Indemnification Agreement | 10-K | 000-18225 | 10.8 | 9/20/2004 | |
| 13.1 | Pages 16 to 71 of the Registrant's 2005 Annual Report to Shareholders | | | | | X |
| 21.1 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm | | | | | X |
| 24.1 | Power of Attorney (included on page 34 of this Annual Report on Form 10-K) | | | | | X |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer | | | | | X |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer | | | | | X |
| 32.1 | Section 1350 Certification of Principal Executive Officer | | | | | X |
| 32.2 | Section 1350 Certification of Principal Financial Officer | | | | | X |

* Indicates a management contract or compensatory plan or arrangement.