CISCO SYSTEMS INC
Form 10-Q
November 18, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended October 25, 2008

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** **incorporation or organization)**	**77-0059951** **(I.R.S. Employer** **Identification Number)**

170 West Tasman Drive

San Jose, California 95134

(Address of principal executive office and zip code)

(408) 526-4000

(Registrant s telephone number, including area code)

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

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

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

YES ¨ NO x

As of November 13, 2008, 5,855,086,794 shares of the registrant s common stock were outstanding.

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Cisco Systems, Inc.

FORM 10-Q for the Quarter Ended October 25, 2008

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CISCO SYSTEMS, INC.

CONSOLIDATED BALANCE SHEETS

(in millions, except par value)

(Unaudited)

	October 25, 2008	July 26, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,197	$ 5,191
Investments	22,566	21,044
Accounts receivable, net of allowance for doubtful accounts of $191 at October 25, 2008 and $177 at July 26, 2008	3,278	3,821
Inventories	1,209	1,235
Deferred tax assets	2,071	2,075
Prepaid expenses and other current assets	2,341	2,333
Total current assets	35,662	35,699
Property and equipment, net	4,181	4,151
Goodwill	12,554	12,392
Purchased intangible assets, net	1,976	2,089
Other assets	4,514	4,403
TOTAL ASSETS	$ 58,887	$ 58,734
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 500	$ 500
Accounts payable	804	869
Income taxes payable	101	107
Accrued compensation	2,100	2,428
Deferred revenue	6,276	6,197
Other current liabilities	3,767	3,757
Total current liabilities	13,548	13,858
Long-term debt	6,371	6,393
Income taxes payable	659	749
Deferred revenue	2,568	2,663
Other long-term liabilities	682	669
Total liabilities	23,828	24,332

Minority interest	24	49
Shareholders equity:		
Preferred stock, no par value: 5 shares authorized; none issued and outstanding		
Common stock and additional paid-in capital, $0.001 par value: 20,000 shares authorized; 5,864 and 5,893 shares issued and outstanding at October 25, 2008 and July 26, 2008, respectively	33,791	33,505
Retained earnings	1,580	120
Accumulated other comprehensive income (loss)	(336)	728
Total shareholders equity	35,035	34,353
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 58,887	$ 58,734

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per-share amounts)

(Unaudited)

	Three Months Ended October 25, 2008	Three Months Ended October 27, 2007
NET SALES:		
Product	$ 8,635	$ 8,015
Service	1,696	1,539
Total net sales	10,331	9,554
COST OF SALES:		
Product	2,981	2,830
Service	669	584
Total cost of sales	3,650	3,414
GROSS MARGIN	6,681	6,140
OPERATING EXPENSES:		
Research and development	1,406	1,232
Sales and marketing	2,283	2,078
General and administrative	395	342
Amortization of purchased intangible assets	112	117
In-process research and development	3	3
Total operating expenses	4,199	3,772
OPERATING INCOME	2,482	2,368
Interest income, net	195	223
Other income (loss), net	(72)	31
Interest and other income (loss), net	123	254
INCOME BEFORE PROVISION FOR INCOME TAXES	2,605	2,622
Provision for income taxes	404	417
NET INCOME	$ 2,201	$ 2,205
Net income per share:		
Basic	$ 0.37	$ 0.36
Diluted	$ 0.37	$ 0.35
Shares used in per-share calculation:		

Basic	5,881	6,087
Diluted	5,972	6,330

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

	Three Months Ended	
	October 25, 2008	October 27, 2007
Cash flows from operating activities:		
Net income	$ 2,201	$ 2,205
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	393	421
Employee share-based compensation expense	282	226
Share-based compensation expense related to acquisitions and investments	22	24
Provision for doubtful accounts	17	18
Deferred income taxes	26	(491)
Excess tax benefits from share-based compensation	(17)	(252)
In-process research and development	3	3
Net losses (gains) on investments	70	(54)
Change in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	453	554
Inventories	8	7
Lease receivables, net	(65)	(127)
Accounts payable	(35)	32
Income taxes payable and receivable	(83)	394
Accrued compensation	(197)	(99)
Deferred revenue	(2)	70
Other assets	(405)	81
Other liabilities	47	77
Net cash provided by operating activities	2,718	3,089
Cash flows from investing activities:		
Purchases of investments	(12,461)	(4,360)
Proceeds from sales of investments	6,833	2,917
Proceeds from maturities of investments	3,509	609
Acquisition of property and equipment	(361)	(296)
Acquisition of businesses, net of cash and cash equivalents acquired	(288)	(45)
Change in investments in privately held companies	(11)	(20)
Other	(60)	(65)
Net cash used in investing activities	(2,839)	(1,260)
Cash flows from financing activities:		
Issuance of common stock	224	1,539
Repurchase of common stock	(1,002)	(2,993)
Excess tax benefits from share-based compensation	17	252
Other	(112)	58
Net cash used in financing activities	(873)	(1,144)

Net (decrease) increase in cash and cash equivalents	(994)	685
Cash and cash equivalents, beginning of period	5,191	3,728
Cash and cash equivalents, end of period	$ 4,197	$ 4,413

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(in millions)

(Unaudited)

Three Months Ended October 27, 2007	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
BALANCE AT JULY 28, 2007	6,100	$ 30,687	$ 231	$ 562	$ 31,480
Cumulative effect of adopting FIN 48		249	202		451
BALANCE AT JULY 29, 2007	6,100	30,936	433	562	31,931
Net income			2,205		2,205
Change in unrealized gains and losses on investments, net of tax				599	599
Cumulative translation adjustment and other				80	80
Comprehensive income					2,884
Issuance of common stock	78	1,539			1,539
Repurchase of common stock	(96)	(496)	(2,517)		(3,013)
Tax benefits from employee stock incentive plans		279			279
Purchase acquisitions		2			2
Employee share-based compensation expense		226			226
Share-based compensation expense related to acquisitions and investments		24			24
BALANCE AT OCTOBER 27, 2007	6,082	$ 32,510	$ 121	$ 1,241	$ 33,872

Three Months Ended October 25, 2008	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
BALANCE AT JULY 26, 2008	5,893	$ 33,505	$ 120	$ 728	$ 34,353
Net income			2,201		2,201
Change in unrealized gains and losses on investments, net of tax				(447)	(447)
Cumulative translation adjustment and other				(617)	(617)
Comprehensive income					1,137
Issuance of common stock	17	224			224
Repurchase of common stock	(46)	(271)	(741)		(1,012)
Tax benefits from employee stock incentive plans		19			19
Purchase acquisitions		10			10
Employee share-based compensation expense		282			282
Share-based compensation expense related to acquisitions and investments		22			22

BALANCE AT OCTOBER 25, 2008	5,864	$ 33,791	$ 1,580	$ (336)	$ 35,035

Supplemental Information

In September 2001, the Company s Board of Directors authorized a stock repurchase program. As of October 25, 2008, the Company s Board of Directors had authorized an aggregate repurchase of up to $62 billion of common stock under this program. For additional information regarding stock repurchases, see Note 12 to the Consolidated Financial Statements. The stock repurchases since the inception of this program and the related impact on shareholders equity are summarized in the table below (in millions):

	Shares of Common Stock	Common Stock and Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders Equity
Repurchases of common stock	2,646	$ 9,834	$ 44,745	$	$ 54,579

See Notes to Consolidated Financial Statements.

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CISCO SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The fiscal year for Cisco Systems, Inc. (the Company or Cisco) is the 52 or 53 weeks ending on the last Saturday in July. Fiscal 2009 and 2008 are 52-week fiscal years. The Consolidated Financial Statements include the accounts of Cisco and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. The Company conducts business globally and is primarily managed on a geographic basis in the following theaters: United States and Canada; European Markets; Emerging Markets; Asia Pacific; and Japan. The Emerging Markets theater consists of Eastern Europe, Latin America, the Middle East and Africa, and Russia and the Commonwealth of Independent States (CIS).

The accompanying financial data as of October 25, 2008 and for the three months ended October 25, 2008 and October 27, 2007 has been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. The July 26, 2008 Consolidated Balance Sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto, included in the Company s Annual Report on Form 10-K for the fiscal year ended July 26, 2008.

In the opinion of management, all adjustments (which include normal recurring adjustments, except as disclosed herein) necessary to present fairly the statement of financial position as of October 25, 2008, and results of operations, cash flows, and shareholders equity for the three months ended October 25, 2008 and October 27, 2007, as applicable, have been made. The results of operations for the three months ended October 25, 2008 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

During the first quarter of fiscal 2009, the Company began to allocate certain costs, which had previously been recorded in general and administrative expenses (related to information technology, financing business, and human resources), to sales and marketing, research and development, and cost of sales, as applicable. These changes also resulted in reclassifications to prior period gross margin by theater amounts. In addition, the Company has made certain reclassifications to prior period amounts relating to net sales by theater and net sales for similar groups of products due to refinement of the respective categories. The Company has made certain other reclassifications to prior period amounts in order to conform to the current period s presentation.

2. Summary of Significant Accounting Policies

(a) Fair Value Measures

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and enhances fair value measurement disclosure. In October 2008, the FASB issued FSP 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active, and provides guidance on the key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. Effective July 27, 2008, the Company adopted the measurement and disclosure requirements related to financial assets and financial liabilities. The adoption of SFAS 157 for financial assets and financial liabilities did not have a material impact on the Company s results of operations or the fair values of its financial assets and liabilities.

FASB Staff Position 157-2, Effective Date of FASB Statement No. 157, (FSP 157-2) delayed the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal 2010. The Company is currently assessing the impact that the application of SFAS 157 to nonfinancial assets and liabilities will have on its results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). Under SFAS 159, a company may choose, at specified election dates, to measure eligible items at fair value and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Effective July 27, 2008, the Company adopted SFAS 159, but the Company has not elected the fair value option for any eligible financial instruments as of October 25, 2008.

(b) Computation of Net Income per Share

SFAS No. 128, Earnings per Share, requires that employee equity share options, unvested shares, and similar equity instruments granted by the Company be treated as potential common shares outstanding in computing diluted earnings per share. Diluted shares outstanding include the dilutive effect of in-the-money options and nonvested restricted stock and stock units, which is calculated based on the average share price for each fiscal period using the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares.

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(c) Recent Accounting Pronouncements

SFAS 141(R) and SFAS 160

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS 141(R)) and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS 160). SFAS 141(R) will significantly change current practices regarding business combinations. Among the more significant changes, SFAS 141(R) expands the definition of a business and a business combination; requires the acquirer to recognize the assets acquired, liabilities assumed and noncontrolling interests (including goodwill), measured at fair value at the acquisition date; requires acquisition-related expenses and restructuring costs to be recognized separately from the business combination; requires assets acquired and liabilities assumed from contractual and noncontractual contingencies to be recognized at their acquisition-date fair values with subsequent changes recognized in earnings; and requires in-process research and development to be capitalized at fair value as an indefinite-lived intangible asset. SFAS 160 will change the accounting and reporting for minority interests, reporting them as equity separate from the parent entity s equity, as well as requiring expanded disclosures. SFAS 141(R) and SFAS 160 are effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact that SFAS 141(R) and SFAS 160 will have on its results of operations and financial position.

SFAS 161

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161), which requires additional disclosures about the objectives of using derivative instruments, the method by which the derivative instruments and related hedged items are accounted for under FASB Statement No.133 and its related interpretations, and the effect of derivative instruments and related hedged items on financial position, financial performance, and cash flows. SFAS 161 also requires disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company is currently assessing the impact that the adoption of SFAS 161 will have on its financial statement disclosures.

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3. Business Combinations

(a) Purchase Acquisitions

A summary of the purchase acquisitions for the three months ended October 25, 2008 is as follows (in millions):

	Purchase Consideration	In-Process R&D Expense	Purchased Intangible Assets	Goodwill
Pure Networks, Inc.	$ 105	$	$ 30	$ 79
PostPath, Inc.	197	3	52	152
Total	$ 302	$ 3	$ 82	$ 231

The Company acquired Pure Networks, Inc. to provide solutions designed to allow end users to easily set up and manage a home network and connect a range of devices, applications and services.

The Company acquired PostPath, Inc. to enhance the existing email and calendaring capabilities of Cisco s WebEx Connect collaboration platform.

Under the terms of the definitive agreements related to the Company s purchase acquisitions completed during the three months ended October 25, 2008, the purchase consideration consisted of cash and fully vested stock options assumed. The purchase consideration for the Company s purchase acquisitions is also allocated to tangible assets acquired and liabilities assumed.

The Consolidated Financial Statements include the operating results of each business from the date of acquisition. Pro forma results of operations for the acquisitions completed during the three months ended October 25, 2008 have not been presented because the effects of the acquisitions, individually or in the aggregate, were not material to the Company s financial results.

(b) Compensation Expense Related to Acquisitions and Investments

The following table presents the compensation expense related to acquisitions and investments (in millions):

	Three Months Ended	
	October 25, 2008	October 27, 2007
Share-based compensation expense	$ 22	$ 24
Cash compensation expense	122	15
Total	$ 144	$ 39

Share-Based Compensation Expense

As of October 25, 2008, the remaining balance of share-based compensation related to acquisitions and investments to be recognized over the vesting periods was approximately $235 million.

Cash Compensation Expense

In connection with the Company s purchase acquisitions, asset purchases, and acquisitions of variable interest entities, the Company has agreed to pay certain additional amounts contingent upon the achievement of certain agreed-upon technology, development, product, or other milestones, or the continued employment with the Company of certain employees of the acquired entities. In each case, any additional amounts paid will be recorded as compensation expense. As of October 25, 2008, the Company may be required to recognize future compensation expense pursuant to these agreements of up to $454 million, which includes the remaining potential amount of additional compensation expense related to Nuova Systems, Inc., as discussed below.

Nuova Systems, Inc.

During fiscal 2008, the Company purchased the remaining interests in Nuova Systems, Inc. (Nuova Systems) not previously held by the Company, representing approximately 20% of Nuova Systems. Under the terms of the merger agreement, the former minority interest holders of Nuova Systems are eligible to receive up to three milestone payments based on agreed-upon formulas. During the first quarter of fiscal 2009, the Company recorded $19 million of compensation expense, and through October 25, 2008, the Company has recorded aggregate compensation expense of $296 million related to the fair value of amounts that are expected to be earned by the minority interest holders pursuant to a vesting schedule. Actual amounts payable to the former minority interest holders of Nuova Systems will depend upon achievement under the agreed-upon formulas.

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Subsequent changes to the fair value of the amounts probable of being earned and the continued vesting will result in adjustments to the recorded compensation expense. The potential amount that could be recorded as compensation expense may be up to a maximum of $678 million, including the $296 million that has been expensed as of October 25, 2008. The compensation is expected to be paid during fiscal 2010 through fiscal 2012.

4. Goodwill and Purchased Intangible Assets

(a) Goodwill

The following table presents the changes in goodwill allocated to the Company s reportable segments during the three months ended October 25, 2008 (in millions):

	Balance at July 26, 2008	Acquisitions	Other	Balance at October 25, 2008
United States and Canada	$ 9,059	$ 179	$	$ 9,238
European Markets	1,650	28	(65)	1,613
Emerging Markets	405	11	(4)	412
Asia Pacific	479	12		491
Japan	799	1		800
Total	$ 12,392	$ 231	$ (69)	$ 12,554

In the table above, Other primarily includes foreign currency translation and purchase accounting adjustments.

(b) Purchased Intangible Assets

The following table presents details of the purchased intangible assets acquired through business combinations during the three months ended October 25, 2008 (in millions, except years):

	TECHNOLOGY		CUSTOMER RELATIONSHIPS		TOTAL
	Weighted-Average Useful Life (in Years)	Amount	Weighted-Average Useful Life (in Years)	Amount	Amount
Pure Networks, Inc.	4.0	$ 27	3.0	$ 3	$ 30
PostPath, Inc.	6.0	52			52
Total		$ 79		$ 3	$ 82

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

October 25, 2008	Gross	Accumulated Amortization	Net
Technology[(1)]	$ 1,864	$ (1,002)	$ 862
Customer relationships	1,824	(758)	1,066
Other	247	(199)	48

Total	$ 3,935	$ (1,959)	$ 1,976

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July 26, 2008	Gross	Accumulated Amortization	Net
Technology[1]	$ 1,785	$ (905)	$ 880
Customer relationships	1,821	(674)	1,147
Other	247	(185)	62
Total	$ 3,853	$ (1,764)	$ 2,089

(1) The technology category includes technology intangible assets acquired through business combinations as well as technology licenses.

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

	Three Months Ended	
	October 25, 2008	October 27, 2007
Amortization of purchased intangible assets		
Cost of sales	$ 59	$ 61
Operating expenses	112	117
Total	$ 171	$ 178

The estimated future amortization expense of purchased intangible assets as of October 25, 2008 is as follows (in millions):

Fiscal Year	Amount
2009 (remaining nine months)	$ 461
2010	532
2011	442
2012	306
2013	220
Thereafter	15
Total	$ 1,976

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5. Balance Sheet Details

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

	October 25, 2008	July 26, 2008
Inventories:		
Raw materials	$ 144	$ 111
Work in process	65	53
Finished goods:		
Distributor inventory and deferred cost of sales	445	452
Manufactured finished goods	331	381
Total finished goods	776	833
Service-related spares	179	191
Demonstration systems	45	47
Total	$ 1,209	$ 1,235
Property and equipment, net:		
Land, buildings, and leasehold improvements	$ 4,438	$ 4,445
Computer equipment and related software	1,775	1,770
Production, engineering, and other equipment	4,884	4,839
Operating lease assets	205	209
Furniture and fixtures	446	439
	11,748	11,702
Less accumulated depreciation and amortization	(7,567)	(7,551)
Total	$ 4,181	$ 4,151
Other assets:		
Deferred tax assets	$ 1,886	$ 1,770
Investments in privately held companies	703	706
Lease receivables, net	842	862
Financed service contracts	612	588
Other	471	477
Total	$ 4,514	$ 4,403
Deferred revenue:		
Service	$ 5,955	$ 6,133
Product:		
Unrecognized revenue on product shipments and other deferred revenue	2,212	2,152
Cash receipts related to unrecognized revenue from two-tier distributors	677	575
Total product deferred revenue	2,889	2,727

Total	$ 8,844	$ 8,860
Reported as:		
Current	$ 6,276	$ 6,197
Noncurrent	2,568	2,663
Total	$ 8,844	$ 8,860

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6. Financing Receivables and Guarantees

(a) Lease Receivables

Lease receivables represent sales-type and direct-financing leases resulting from the sale of the Company s and complementary third-party products. These lease arrangements typically have terms from two to three years and are generally collateralized by a security interest in the underlying assets. The net lease receivables are summarized as follows (in millions):

	October 25, 2008	July 26, 2008
Gross lease receivables	$ 1,700	$ 1,730
Unearned income	(171)	(178)
Allowances	(148)	(136)
Lease receivables, net	$ 1,381	$ 1,416
Reported as:		
Current	$ 539	$ 554
Noncurrent	842	862
Lease receivables, net	$ 1,381	$ 1,416

Contractual maturities of the gross lease receivables at October 25, 2008 were $523 million in the remaining nine months of fiscal 2009, $539 million in fiscal 2010, $363 million in fiscal 2011, $187 million in fiscal 2012, and $88 million in fiscal 2013 and thereafter. Actual cash collections may differ from the contractual maturities due to early customer buyouts, refinancings, or defaults.

(b) Financed Service Contracts

Financed service contracts are summarized as follows (in millions):

	October 25, 2008	July 26, 2008
Gross financed service contracts	$ 1,393	$ 1,328
Allowances	(15)	(10)
Financed service contracts, net	$ 1,378	$ 1,318
Reported as:		
Current	$ 766	$ 730
Noncurrent	612	588
Financed service contracts, net	$ 1,378	$ 1,318

The revenue related to financed service contracts, which primarily relates to technical support services, is deferred and included in deferred service revenue. The revenue is recognized ratably over the period during which the related services are to be performed, which is typically from one to three years.

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(c) Loan Receivables

Loan receivables are summarized as follows (in millions):

	October 25, 2008	July 26, 2008
Gross loan receivables	$ 575	$ 607
Allowances	(91)	(128)
Loan receivables, net	$ 484	$ 479
Reported as:		
Current	$ 270	$ 263
Noncurrent	214	216
Loan receivables, net	$ 484	$ 479

A portion of the revenue related to loan receivables is deferred and included in deferred product revenue based on revenue recognition criteria.

(d) Financing Guarantees

The Company provides financing guarantees, which are generally for various third-party financing arrangements extended to channel partners and other customers. The Company could be called upon to make payments under these guarantees in the event of nonpayment to the third party. As of October 25, 2008 and July 26, 2008, the total maximum potential future payments related to these guarantees were approximately $875 million and $830 million, respectively, of which approximately $620 million and $610 million, respectively, were recorded as deferred revenue on the Consolidated Balance Sheets in accordance with revenue recognition policies and FIN 45.

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7. Investments

The following tables summarize the Company s investments (in millions):

October 25, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
Government securities	$ 7,443	$ 42	$ (2)	$ 7,483
Government agency securities	9,358	29	(10)	9,377
Corporate debt securities	4,549	17	(195)	4,371
Asset-backed securities	647		(29)	618
Total fixed income securities	21,997	88	(236)	21,849
Publicly traded equity securities	841	84	(208)	717
Total	$ 22,838	$ 172	$ (444)	$ 22,566

July 26, 2008	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed income securities:				
Government securities	$ 7,249	$ 50	$ (33)	$ 7,266
Government agency securities	5,815	34	(10)	5,839
Corporate debt securities	5,814	24	(96)	5,742
Asset-backed securities	1,035	5	(18)	1,022
Total fixed income securities	19,913	113	(157)	19,869
Publicly traded equity securities	860	391	(76)	1,175
Total	$ 20,773	$ 504	$ (233)	$ 21,044

During the three months ended October 25, 2008, the Company realized net losses of $152 million on fixed income securities and realized net gains of $91 million on publicly traded equity securities. Included in the realized net losses and gains were $183 million and $17 million of impairment losses on fixed income and publicly traded equity securities, respectively. The impairment charges were due to a decline in the fair value of the investments below their cost basis that were judged to be other-than-temporary and were recorded as a reduction to the amortized cost of the respective investments. There were no impairments of fixed income or publicly traded equity securities during the three months ended October 27, 2007.

The following table summarizes the maturities of the Company s fixed income securities at October 25, 2008 (in millions):

	Amortized Cost	Fair Value
Less than 1 year	$ 12,426	$ 12,411
Due in 1 to 2 years	3,944	3,941
Due in 2 to 5 years	4,878	4,819
Due after 5 years	749	678
Total	$ 21,997	$ 21,849

Actual maturities may differ from the contractual maturities because borrowers may have the right to call or prepay certain obligations.

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8. Fair Value Measures

SFAS 157 defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when pricing the asset or liability.

(a) Fair Value Hierarchy

SFAS 157 establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument s categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. SFAS 157 establishes three levels of inputs that may be used to measure fair value:

Level 1

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

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(b) Asset and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis as of October 25, 2008 were as follows:

	Fair Value Measurements Using			
October 25, 2008	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Assets:				
Money market funds	$ 2,114	$	$	$ 2,114
Government securities		7,872		7,872
Government agency securities		9,453		9,453
Corporate debt securities		5,188		5,188
Asset-backed securities			618	618
Publicly traded equity securities	717			717
Derivative assets		42		42
Total assets measured at fair value	$ 2,831	$ 22,555	$ 618	$ 26,004
Liabilities:				
Derivative liabilities	$	$ 79	$	$ 79
Total liabilities measured at fair value	$	$ 79	$	$ 79

Fixed income securities classified as Level 2 assets consist of securities priced using quoted market prices for similar instruments, non-binding market prices that are corroborated by observable market data, or discounted cash flow techniques. The Company s derivative instruments are classified as Level 2 as they are not actively traded and are valued using pricing models that use observable market inputs. Level 3 assets include asset-backed securities whose values are determined based on discounted cash flow models using inputs that the Company could not corroborate with market quotes. A change in the observability of significant inputs for the valuation of asset-backed securities caused these assets to be classified as Level 3 assets as of October 25, 2008.

Assets and liabilities measured at fair value on a recurring basis were presented on the Company s consolidated balance sheet as of October 25, 2008 as follows:

	Fair Value Measurements Using			
October 25, 2008	**Quoted Prices in Active Markets for Identical Instruments (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Balance**
Cash equivalents	$ 2,114	$ 1,282	$	$ 3,396
Investments	717	21,231	618	22,566
Prepaid expenses and other current assets		42		42

Total assets measured at fair value	$ 2,831	$ 22,555	$ 618	$ 26,004
Other current liabilities	$	$ 79	$	$ 79
Total liabilities measured at fair value	$	$ 79	$	$ 79

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(c) Assets Measured at Fair Value on a Nonrecurring Basis

The following table presents the Company s private investments that were measured at fair value on a nonrecurring basis as of October 25, 2008 and the losses recorded during the three months ended October 25, 2008 on those assets (in millions):

	Balance as of October 25, 2008	Fair Value Measured Using: Quoted Prices In Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	(Losses) for the Three Months Ended October 25, 2008
Private Investments	$ 13	$	$	$ 13	$ (23)

These private investments, all still held as of October 25, 2008, were measured at fair value during the first quarter of fiscal 2009 due to events or circumstances the Company identified that significantly impacted the fair value of these investments, resulting in an impairment charge of $23 million which was included in earnings for the period. The Company measured fair value using financial metrics, comparison to other private and public companies, analysis of the financial condition and near-term prospects of the investees, including recent financing activities and their capital structure as well as other economic variables. These investments were classified as Level 3 assets because the Company used unobservable inputs to value them, reflecting the Company s assumptions about the assumptions market participants would use in pricing these investments due to the absence of quoted market prices and inherent lack of liquidity.

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9. Borrowings

(a) Long-Term Debt

In February 2006, the Company issued $500 million of senior floating interest rate notes based on the London Interbank Offered Rate (LIBOR) due 2009 (the 2009 Notes), $3.0 billion of 5.25% senior notes due 2011 (the 2011 Notes), and $3.0 billion of 5.50% senior notes due 2016 (the 2016 Notes), for an aggregate principal amount of $6.5 billion. The following table summarizes the Company s long-term debt (in millions, except percentages):

	October 25, 2008		July 26, 2008	
	Amount	Effective Rate	Amount	Effective Rate
Senior notes:				
Floating-rate notes, due 2009	$ 500	2.89%	$ 500	2.74%
5.25% fixed-rate notes, due 2011	3,000	3.12%	3,000	3.12%
5.50% fixed-rate notes, due 2016	3,000	4.34%	3,000	4.34%
Total senior notes	6,500		6,500	
Other notes	3		4	
Unaccreted discount	(14)		(15)	
Hedge accounting adjustment of the carrying amount of the fixed-rate debt	382		404	
Total	$ 6,871		$ 6,893	
Reported as:				
Current portion of long-term debt	$ 500		$ 500	
Long-term debt	6,371		6,393	
Total	$ 6,871		$ 6,893	

During the third quarter of fiscal 2008, the Company terminated the interest rate swaps entered into in connection with the 2011 Notes and the 2016 Notes and received proceeds of $432 million, net of accrued interest, which was recorded as a hedge accounting adjustment of the carrying amount of the fixed-rate debt and is being amortized as a reduction to interest expense over the remaining terms of the fixed-rate notes. The effective rates for the fixed-rate debt include the interest on the notes, the amortization of the hedge accounting adjustment and the accretion of the discount.

The 2011 Notes and the 2016 Notes are redeemable by the Company at any time, subject to a make-whole premium. Based on market prices, the fair value of the Company s long-term debt, including the current portion of long-term debt was $6.3 billion as of October 25, 2008. The Company was in compliance with all debt covenants as of October 25, 2008.

Interest is payable quarterly on the 2009 Notes and semi-annually on the 2011 Notes and 2016 Notes. Interest expense and cash paid for interest are summarized as follows (in millions):

	Three Months Ended	
	October 25, 2008	October 27, 2007
Interest expense	$ 64	$ 96
Cash paid for interest	$ 165	$ 178

(b) Credit Facility

In August 2007, the Company entered into a credit agreement with certain institutional lenders that provides for a $3.0 billion unsecured revolving credit facility that is scheduled to expire on August 17, 2012. Due to the bankruptcy of one of the lenders during the first quarter of fiscal 2009, the Company believes the amount available under the credit facility as of October 25, 2008 may be effectively reduced to $2.9 billion.

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Any advances under the credit agreement will accrue interest at rates that are equal to, based on certain conditions, either (i) the higher of the Federal Funds rate plus 0.50% or Bank of America s prime rate as announced from time to time, or (ii) LIBOR plus a margin that is based on the Company s senior debt credit ratings as published by Standard & Poor s Ratings Services and Moody s Investors Service, Inc. The credit agreement requires that the Company maintain an interest coverage ratio as defined in the agreement.

As of October 25, 2008, the Company was in compliance with the required interest coverage ratio and the Company had not borrowed any funds under the credit facility. The Company may also, upon the agreement of either the then existing lenders or of additional lenders not currently parties to the agreement, increase the commitments under the credit facility up to a total of $5.0 billion and/or extend the expiration date of the credit facility up to August 15, 2014.

10. Derivative Instruments

The Company uses derivative instruments primarily to manage exposures to foreign currency, interest rate, and equity security price risks. The Company s primary objective in holding derivatives is to reduce the volatility of earnings and cash flows associated with changes in foreign currency, interest rates, and equity security prices. The Company s derivatives expose it to credit risk to the extent that the counterparties may be unable to meet the terms of the agreement. The Company seeks to mitigate such risks by limiting its counterparties to major financial institutions. In addition, the potential risk of loss with any one counterparty resulting from this type of credit risk is monitored. Management does not expect material losses as a result of defaults by counterparties.

(a) Foreign Currency Derivatives

The Company s foreign exchange forward and option contracts are summarized as follows (in millions):

	October 25, 2008		July 26, 2008	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Forward contracts:				
Purchased	$ 1,732	$ (38)	$ 1,803	$ 5
Sold	$ 880	$ 80	$ 902	$ 2
Option contracts:				
Purchased	$ 1,902	$ 12	$ 1,440	$ 50
Sold	$ 1,760	$ (87)	$ 1,256	$ (6)

The Company conducts business globally in numerous currencies. As such, it is exposed to adverse movements in foreign currency exchange rates. To limit the exposure related to foreign currency changes, the Company enters into foreign currency contracts. The Company does not enter into foreign exchange forward or option contracts for trading purposes.

The Company enters into foreign exchange forward contracts to reduce the short-term effects of foreign currency fluctuations on assets and liabilities such as foreign currency receivables, including long-term customer financings, investments, and payables. Gains and losses on the contracts are included in other income (loss), net, and offset foreign exchange gains and losses from the revaluation of intercompany balances or other current assets, investments, or liabilities denominated in currencies other than the functional currency of the reporting entity. The Company s foreign exchange forward contracts related to current assets and liabilities generally range from one to three months in original maturity. Additionally, the Company has entered into foreign exchange forward contracts with maturities of up to two years related to long-term customer financings. The foreign exchange forward contracts related to investments generally have maturities of less than two years. The Company also hedges certain net investments in its foreign subsidiaries with forward contracts which generally have maturities of less than six months.

The Company hedges certain foreign currency forecasted transactions related to certain operating expenses and service cost of sales with currency options and forward contracts. These currency option and forward contracts generally have maturities of less than 18 months and these transactions are designated as cash flow hedges. The effective portion of the derivative s gain or loss is initially reported as a component of accumulated other comprehensive income (loss) and subsequently reclassified into earnings when the hedged exposure affects earnings. The ineffective portion, if any, of the gain or loss is reported in earnings immediately. During the three months ended October 25, 2008, and October 27, 2007, there were no significant gains or losses recognized in earnings for hedge ineffectiveness. The Company did not discontinue any hedges during any of the periods presented because it was probable that the original forecasted transaction would not occur.

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(b) Interest Rate Derivatives

The Company s interest rate derivatives are summarized as follows (in millions):

	October 25, 2008		July 26, 2008	
	Notional Amount	**Fair Value**	**Notional Amount**	**Fair Value**
Interest rate swaps investments	$ 500	$ (4)	$ 1,000	$ (4)

The Company s primary objective for holding fixed income securities is to achieve an appropriate investment return consistent with preserving principal and managing risk. To realize these objectives, the Company may utilize interest rate swaps or other derivatives designated as fair value or cash flow hedges. As of October 25, 2008, the Company was a party to $500 million of interest rate swaps designated as fair value hedges of its investment portfolio.

During the three months ended October 25, 2008, the Company received proceeds for $500 million of the underlying hedged investments and terminated the related interest rate swaps designated as fair value hedges. Under these interest rate swap contracts, the Company made fixed-rate interest payments and receives interest payments based on LIBOR. The effect of these swaps was to convert fixed-rate returns to floating-rate returns based on LIBOR for a portion of the Company s fixed income portfolio. The gains and losses related to changes in the value of the interest rate swaps were included in other income (loss), net, and offset the changes in fair value of the underlying hedged investment. In November 2008, the Company received proceeds for the remaining $500 million of underlying hedged investments and the related interest rate swaps designated as fair value hedges were terminated.

(c) Equity Derivatives

The Company s equity derivatives are summarized as follows (in millions):

	October 25, 2008		July 26, 2008	
	Notional Amount	**Fair Value**	**Notional Amount**	**Fair Value**
Forward sale agreements	$	$	$ 157	$ 32

The Company maintains a portfolio of publicly traded equity securities which are subject to price risk. The Company may hold equity securities for strategic purposes or to diversify the Company s overall investment portfolio. To manage its exposure to changes in the fair value of certain equity securities, the Company may enter into equity derivatives, including forward sale and option agreements. During the three months ended October 25, 2008, the Company terminated its previously existing forward sale agreements on publicly traded equity securities designated as fair value hedges. The gains and losses due to changes in the value of the hedging instruments were included in other income (loss), net, and offset the change in the fair value of the underlying hedged investment.

11. Commitments and Contingencies

(a) Operating Leases

The Company leases office space in several U.S. locations. Outside the United States, larger leased sites include sites in Australia, Belgium, Canada, China, France, Germany, India, Israel, Italy, Japan, and the United Kingdom. Future annual minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of October 25, 2008 are as follows (in millions):

Fiscal Year	**Amount**
2009 (remaining nine months)	$ 211

2010	220
2011	183
2012	136
2013	122
Thereafter	519
Total	$ 1,391

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(b) Purchase Commitments with Contract Manufacturers and Suppliers

The Company purchases components from a variety of suppliers and uses several contract manufacturers to provide manufacturing services for its products. During the normal course of business, in order to manage manufacturing lead times and help ensure adequate component supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure inventory based upon criteria as defined by the Company or that establish the parameters defining the Company s requirements. In certain instances, these agreements allow the Company the option to cancel, reschedule, and adjust the Company s requirements based on its business needs prior to firm orders being placed. Consequently, only a portion of the Company s reported purchase commitments arising from these agreements are firm, noncancelable, and unconditional commitments. As of October 25, 2008 and July 26, 2008, the Company had total purchase commitments for inventory of $2.9 billion and $2.7 billion, respectively.

In addition, the Company records a liability for firm, noncancelable, and unconditional purchase commitments for quantities in excess of its future demand forecasts consistent with the valuation of the Company s excess and obsolete inventory. As of October 25, 2008 and July 26, 2008, the liability for these purchase commitments was $186 million and $184 million, respectively, and was included in other current liabilities.

(c) Compensation Expense Related to Acquisitions and Investments

In connection with the Company s purchase acquisitions, asset purchases, and acquisitions of variable interest entities, the Company has agreed to pay certain additional amounts contingent upon the achievement of certain agreed-upon technology, development, product, or other milestones or the continued employment with the Company of certain employees of acquired entities. See Note 3.

(d) Other Commitments

The Company also has certain funding commitments primarily related to its investments in privately held companies and venture funds, some of which are based on the achievement of certain agreed-upon milestones, and some of which are required to be funded on demand. The funding commitments were approximately $323 million and $359 million as of October 25, 2008 and July 26, 2008, respectively.

(e) Variable Interest Entities

In the ordinary course of business, the Company has investments in privately held companies and provides financing to certain customers through its wholly owned subsidiaries, which may be considered to be variable interest entities. The Company has evaluated its investments in these privately held companies and customer financings and determined that there were no significant unconsolidated variable interest entities as of October 25, 2008.

(f) Guarantees and Product Warranties

The following table summarizes the activity related to the product warranty liability during the three months ended October 25, 2008 and October 27, 2007 (in millions):

	Three Months Ended	
	October 25, 2008	**October 27, 2007**
Balance at beginning of period	$ 399	$ 340
Provision for warranties issued	101	135
Payments	(119)	(126)
Balance at end of period	$ 381	$ 349

The Company accrues for warranty costs as part of its cost of sales based on associated material product costs, labor costs for technical support staff, and associated overhead. The products sold are generally covered by a warranty for periods ranging from 90 days to five years, and for some products the Company provides a limited lifetime warranty.

In the normal course of business, the Company indemnifies other parties, including customers, lessors, and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other parties harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, the Company has entered into indemnification agreements with its officers and directors, and the Company s bylaws contain similar indemnification obligations to the Company s agents. It is not possible to determine the maximum potential amount under these indemnification agreements due to the Company s limited history with prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on the Company s operating results, financial position, or cash flows.

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The Company also provides financing guarantees, which are generally for various third-party financing arrangements to channel partners and other customers. See Note 6. The Company s other arrangements as of October 25, 2008 that were subject to recognition and disclosure requirements under FIN 45 were not material.

(g) Legal Proceedings

Brazilian authorities are investigating certain employees of the Company s Brazilian subsidiary and certain employees of a Brazilian importer of the Company s products relating to the allegation of evading import taxes and other alleged improper transactions involving the subsidiary and the importer. The Company is conducting a thorough review of the matter. To date, Brazilian authorities have not asserted a claim against the Company. The Company is unable to determine the likelihood of an unfavorable outcome on any potential claims against it or to reasonably estimate a range of loss, if any. In addition, the Company is investigating the allegations regarding improper transactions, the Company has proactively communicated with United States authorities to provide information and report on its findings, and the United States authorities are currently investigating such allegations.

In addition, the Company is 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, the Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

12. Shareholders Equity

(a) Stock Repurchase Program

In September 2001, the Company s Board of Directors authorized a stock repurchase program. As of October 25, 2008, the Company s Board of Directors had authorized an aggregate repurchase of up to $62 billion of common stock under this program and the remaining authorized repurchase amount was $7.4 billion with no termination date. The stock repurchase activity under the stock repurchase program during the first three months of fiscal 2009 is summarized as follows (in millions, except per-share amounts):

Three Months Ended October 25, 2008	Shares Repurchased	Weighted-Average Price per Share	Amount Repurchased
Cumulative balance at July 26, 2008	2,600	$ 20.60	$ 53,579
Repurchase of common stock [1]	46	21.95	1,000
Cumulative balance at October 25, 2008	2,646	$ 20.62	$ 54,579

(1) Includes stock repurchases that were pending settlement as of October 25, 2008.

The purchase price for the shares of the Company s stock repurchased is reflected as a reduction to shareholders equity. In accordance with Accounting Principles Board Opinion No. 6, Status of Accounting Research Bulletins, the Company is required to allocate the purchase price of the repurchased shares as (i) a reduction to retained earnings until retained earnings are zero and then as an increase to accumulated deficit and (ii) a reduction of common stock and additional paid-in capital. Issuance of common stock and the tax benefit related to employee stock incentive plans are recorded as an increase to common stock and additional paid-in capital.

(b) Other Repurchases of Common Stock

The Company also repurchases shares in settlement of employee tax withholding obligations due upon the vesting of restricted stock or stock units.

(c) Preferred Stock

Under the terms of the Company s Articles of Incorporation, the Board of Directors may determine the rights, preferences, and terms of the Company s authorized but unissued shares of preferred stock.

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(d) Comprehensive Income

The components of comprehensive income are as follows (in millions):

	Three Months Ended	
	October 25, 2008	October 27, 2007
Net income	$ 2,201	$ 2,205
Other comprehensive income:		
Change in unrealized gains and losses on investments, net of tax benefit (expense) of $102 and $(234), for the three months ended October 25, 2008 and October 27, 2007, respectively	(472)	720
Cumulative translation adjustment and other	(617)	80
Comprehensive income before minority interest	1,112	3,005
Change in minority interest	25	(121)
Total	$ 1,137	$ 2,884

The Company consolidates its investment in a venture fund managed by SOFTBANK Corp. and its affiliates (SOFTBANK) as the Company is the primary beneficiary as defined under FIN 46(R). As a result, SOFTBANK s interest in the change in the unrealized gains and losses on the investments in the venture fund is recorded as a component of accumulated other comprehensive income (loss) and is reflected as a change in minority interest.

13. Employee Benefit Plans

(a) Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan, which includes its sub-plan, the International Employee Stock Purchase Plan (together, the Purchase Plan), under which 321.4 million shares of the Company s stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of the Company s stock at a discount of up to 15% of the lesser of the market value on the subscription date or the purchase date, which is approximately six months after the subscription date. The Purchase Plan terminates on January 3, 2010. During the three months ended October 25, 2008 and October 27, 2007, the Company did not issue any shares under the Purchase Plan. As of October 25, 2008, 63 million shares were available for issuance under the Purchase Plan.

(b) Employee Stock Incentive Plans

Stock Incentive Plan Program Description

As of October 25, 2008, the Company had five stock incentive plans: the 2005 Stock Incentive Plan (the 2005 Plan); the 1996 Stock Incentive Plan (the 1996 Plan); the 1997 Supplemental Stock Incentive Plan (the Supplemental Plan); the Cisco Systems, Inc. SA Acquisition Long-Term Incentive Plan (the SA Acquisition Plan); and the Cisco Systems, Inc. WebEx Acquisition Long-Term Incentive Plan (the WebEx Acquisition Plan). In addition, the Company has, in connection with the acquisitions of various companies, assumed the share-based awards granted under stock incentive plans of the acquired companies or issued share-based awards in replacement thereof. Share-based awards are designed to reward employees for their long-term contributions to the Company and provide incentives for them to remain with the Company. The number and frequency of share-based awards are based on competitive practices, operating results of the Company, government regulations, and other factors. Since the inception of the stock incentive plans, the Company has granted share-based awards to a significant percentage of its employees, and the majority has been granted to employees below the vice president level. The Company s primary stock incentive plans are summarized as follows:

2005 Plan

As amended on November 15, 2007, the maximum number of shares issuable under the 2005 Plan over its term is 559 million shares plus the amount of any shares underlying awards outstanding on November 15, 2007 under the 1996 Plan, the SA Acquisition Plan and the WebEx Acquisition Plan that are forfeited or are terminated for any other reason before being exercised or settled. However, any shares underlying awards outstanding on November 15, 2007 under the 1996 Plan, the SA Acquisition Plan, and the WebEx Acquisition Plan that expire unexercised at the end of their maximum terms will not be considered to become available for reissuance under the 2005 Plan. If any awards granted under the 2005 Plan are forfeited or are terminated for any other reason before being exercised or settled, then the shares underlying the awards will again be available under the 2005 Plan. The number of shares available for issuance under the 2005 Plan will be reduced by 2.5 shares for each share awarded as stock grants or stock units.

The 2005 Plan permits the granting of stock options, stock, stock units, and stock appreciation rights to employees (including employee directors and officers) and consultants of the Company and its subsidiaries and affiliates, and non-employee directors of the Company. Stock options granted under the 2005 Plan have an exercise price of at least 100% of the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The stock options will generally become exercisable for 20% or 25% of the option shares one year from the date of grant and then ratably over the following 48 or 36 months, respectively. Stock grants and stock units will generally vest with respect to 20% or 25% of the shares covered by the grant on each of the first through fifth or fourth anniversaries of the date of the grant, respectively. The Compensation and Management

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Development Committee of the Board of Directors has the discretion to use different vesting schedules. Stock appreciation rights may be awarded in combination with stock options or stock grants and such awards shall provide that the stock appreciation rights will not be exercisable unless the related stock options or stock grants are forfeited. Stock grants may be awarded in combination with non-statutory stock options, and such awards may provide that the stock grants will be forfeited in the event that the related non-statutory stock options are exercised.

1996 Plan

The 1996 Plan expired on December 31, 2006, and the Company can no longer make equity awards under the 1996 Plan. The maximum number of shares issuable over the term of the 1996 Plan was 2.5 billion shares. Stock options granted under the 1996 Plan have an exercise price of at least 100% of the fair market value of the underlying stock on the grant date and expire no later than nine years from the grant date. The stock options generally become exercisable for 20% or 25% of the option shares one year from the date of grant and then ratably over the following 48 or 36 months, respectively. Certain other grants have utilized a 60-month ratable vesting schedule. In addition, the Board of Directors, or other committees administering the plan, have the discretion to use a different vesting schedule and have done so from time to time.

Supplemental Plan

The Supplemental Plan expired on December 31, 2007, and the Company can no longer make equity awards under the Supplemental Plan. Officers and members of the Company s Board of Directors were not eligible to participate in the Supplemental Plan. Nine million shares were reserved for issuance under the Supplemental Plan.

Acquisition Plans

In connection with the Company s acquisitions of Scientific-Atlanta, Inc. (Scientific-Atlanta) and WebEx Communications, Inc. (WebEx), the Company adopted the SA Acquisition Plan and the WebEx Acquisition Plan, respectively, each effective upon completion of the applicable acquisition. These plans constitute assumptions, amendments, restatements, and renamings of the 2003 Long-Term Incentive Plan of Scientific-Atlanta and the WebEx Communications, Inc. Amended and Restated 2000 Stock Incentive Plan, respectively. The plans permit the grant of stock options, stock, stock units, and stock appreciation rights to certain employees of the Company and its subsidiaries and affiliates who had been employed by Scientific-Atlanta or its subsidiaries or WebEx or its subsidiaries, as applicable. As a result of the shareholder approval of the amendment and extension of the 2005 Plan, as of November 15, 2007, the Company will no longer make stock option grants or direct share issuances under either the SA Acquisition Plan or the WebEx Acquisition Plan.

General Share-Based Award Information

Stock Option Awards

A summary of the stock option activity is as follows (in millions, except per share amounts):

	STOCK OPTIONS OUTSTANDING	
	Number Outstanding	Weighted-Average Exercise Price per Share
BALANCE AT JULY 28, 2007	1,289	$ 26.60
Granted and assumed	159	31.12
Exercised	(146)	18.50
Canceled/forfeited/expired	(103)	30.74
BALANCE AT JULY 26, 2008	1,199	27.83
Granted and assumed	4	23.04
Exercised [(1)]	(13)	16.82
Canceled/forfeited/expired	(23)	36.51

BALANCE AT OCTOBER 25, 2008	1,167	$	27.77

(1) The total pretax intrinsic value of stock options exercised during the three months ended October 25, 2008 was $104 million.

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The following table summarizes significant ranges of outstanding and exercisable stock options as of October 25, 2008 (in millions, except years and share prices):

		STOCK OPTIONS OUTSTANDING				STOCK OPTIONS EXERCISABLE		
Range of Exercise Prices		**Number Outstanding**	**Weighted-Average Remaining Contractual Life (in Years)**	**Weighted-Average Exercise Price per Share**	**Aggregate Intrinsic Value**	**Number Exercisable**	**Weighted-Average Exercise Price per Share**	**Aggregate Intrinsic Value**
$ 0.01	15.00	90	3.46	$ 11.15	$ 464	82	$ 11.25	$ 412
15.01	18.00	187	4.71	17.29	16	129	17.06	16
18.01	20.00	251	4.32	19.22		206	19.23	
20.01	25.00	222	5.73	22.67		121	22.59	
25.01	30.00	54	7.02	26.71		17	26.90	
30.01	35.00	127	7.80	32.16		26	32.16	
35.01	50.00	14	0.80	42.74		14	42.74	
50.01	72.56	222	0.61	54.90		222	54.90	
Total		1,167	4.34	$ 27.77	$ 480	817	$ 29.25	$ 428

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company s closing stock price of $16.31 as of October 24, 2008, which would have been received by the option holders had those option holders exercised their stock options as of that date. The total number of in-the-money stock options exercisable as of October 25, 2008 was 134 million. As of July 26, 2008, 795 million outstanding stock options were exercisable and the weighted-average exercise price was $29.53.

Restricted Stock and Stock Unit Awards

A summary of the restricted stock and stock unit activity is as follows (in millions, except per share amounts):

	Restricted Stock/Stock Units	**Weighted-Average Price per Share**
BALANCE AT JULY 28, 2007	11	$ 22.52
Granted and assumed	4	27.29
Vested	(4)	22.49
Canceled/forfeited	(1)	24.24
BALANCE AT JULY 26, 2008	10	24.27
Granted and assumed	31	22.87
Vested	(1)	23.32
BALANCE AT OCTOBER 25, 2008	40	$ 23.34

Certain of the restricted stock units are awarded contingent on the future achievement of financial performance metrics.

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Share-Based Awards Available for Grant

A summary of share-based awards available for grant are as follows (in millions):

	Share-Based Awards Available for Grant
BALANCE AT JULY 28, 2007	294
Options granted and assumed	(159)
Restricted stock, stock units, and other share-based awards granted and assumed	(11)
Share-based awards canceled/forfeited/expired	27
Additional shares reserved	211
BALANCE AT JULY 26, 2008	362
Options granted and assumed	(4)
Restricted stock, stock units, and other share-based awards granted and assumed	(77)
Share-based awards canceled/forfeited/expired	11
Additional shares reserved	1
BALANCE AT OCTOBER 25, 2008	293

As reflected in the table above, for each share awarded as restricted stock or subject to a restricted stock unit award under the 2005 plan subsequent to November 15, 2007, an equivalent of 2.5 shares is deducted from the available share-based award balance.

Valuation and Expense Information Under SFAS 123(R)

Share-based compensation expense recognized under SFAS 123(R) consists primarily of expenses for stock options, stock purchase rights, restricted stock, and restricted stock units granted to employees. The following table summarizes employee share-based compensation expense (in millions):

	Three Months Ended	
	October 25, 2008	October 27, 2007
Cost of sales product	$ 11	$ 9
Cost of sales service	31	23
Employee share-based compensation expense in cost of sales	42	32
Research and development	82	65
Sales and marketing	113	99
General and administrative	45	30
Employee share-based compensation expense in operating expenses	240	194