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

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

Cisco Systems, Incorporated [CSCO]
Q1 FY21 Financial Results Conference Call
Thursday, November 12, 2020

Introduction

Welcome, everyone, to Cisco's First Quarter Fiscal 2021 Quarterly Earnings Conference Call. This is Marilyn Mora, Head of Investor Relations, and I'm joined by Chuck Robbins, our Chairman and CEO; and Kelly Kramer, our CFO.

By now you should have seen our earnings press release. A corresponding webcast with slides, including supplemental information, will be made available on our website in the Investor Relations section following the call.

As is customary in Q1, we have made certain reclassifications to prior period amounts to conform to the current period's presentation. Income statements, full GAAP to non-GAAP reconciliation information, balance sheets, cash flow statements and other financial information can also be found in the Financial Information section of our Investor Relations website.

Throughout this conference call, we will be referencing both GAAP and non-GAAP financial results and will discuss product results in terms of revenue and geographic and customer results in terms of product orders, unless stated otherwise. All comparisons made throughout this call will be on a year over year basis.

The matters we will be discussing today include forward-looking statements, including the guidance we will be providing for the second quarter of fiscal 2021. They are subject to the risks and uncertainties, including COVID-19, that we discuss in detail in our documents filed with the SEC, specifically the most recent report on Form 10-K, which identifies important risk factors that could cause actual results to differ materially from those contained in the forward-looking statements.With respect to guidance, please also see the slides and press release that accompany this call for further details. Cisco will not comment on its financial guidance during the quarter unless it is done through an explicit public disclosure.

With that, I'll now turn it over to Chuck.

Opening Remarks

Thanks, Marilyn. First, I want to start off by saying I hope everyone is safe and healthy. I also want to thank our employees for their dedication to our customers and their relentless focus on innovation.

Cisco is off to a solid start in fiscal 2021, and I am proud of these results. Our teams are executing with excellence and we continue to make steady progress on our shift to a software- and subscription-driven model. We are encouraged by the signs of improvement in our business, as we continue to navigate the pandemic and other macro uncertainties.

Our focus is on winning with a differentiated innovation portfolio, long-term growth and being a trusted technology partner for our customers. Over the last few quarters, we've successfully adjusted to new demands by making necessary changes and shifts within our business. We remain closely aligned with our customers to provide them with the mission critical technology they need to stay resilient and move toward adopting new hybrid work models.

In fact, we see many great opportunities ahead, as every company in every industry is accelerating its digital-first strategy. Our customers are rethinking how they support and serve their customers and their employees. They need speed, agility and simplicity. Many customers have shared with me that they're compressing years of work into just a few months. This is why we're driving new innovation that helps our customers connect, secure and automate their environments at a faster pace than ever before. With the right technology and tools, we can be even more effective and productive, and that's what we intend to deliver for our customers.

Going forward, we are focused on building innovation that helps our customers and Cisco thrive in a hybrid cloud world. As we think about the next few years, there are six key areas we are focused on.

First is delivering optimized application experiences for our customers. The application is the lifeline for all organizations and is increasingly how end users access their products and consume their services.

Second is continuing to deliver the secure networking capabilities that Cisco is trusted for as a service, offering even greater simplicity and automation.

The third area is focused on helping communications providers succeed with significant architectural transitions like 400G and 5G. These will be done with a combination of our software assets, silicon and optics capabilities, as well as complete integrated systems. We will deliver these technologies on-prem as well as from the cloud.

Fourth is accelerating the future of work. As many enterprises look to adopt new hybrid work models with more remotely distributed workers than before, we are focused on

helping them deliver consistent experiences, whether working remotely or in the office, from connectivity to collaboration to security.

Fifth is supporting our customers with their mission of securing everything they do. We will continue to deliver the end-to-end intelligent security architecture designed to keep their data private and their people secure.

And the final area is around developing edge technologies that allow application developers to run distributed applications while securely accessing and managing distributed data. We believe that these key areas will drive our growth and success over the coming years.

Now let me share more on our Q1 results. As I mentioned earlier, we saw encouraging signs of improvement in certain areas of our business. Some large customers who were already in the midst of modernizing their infrastructure continue to do so, as we've seen with the ongoing success of the Catalyst 9000. Webex, our security solutions and business resiliency offers also saw strong growth, as our customers are trusting us with their most critical projects.

We are succeeding in transforming our business model, with 78% of our software revenue now sold as a subscription, and we saw double-digit growth in our deferred product revenue. As I mentioned on the last call, you will see us deliver more of our technology as a service to provide more choice and flexibility across our entire portfolio.

Our new technology pipeline remains strong as we continue to accelerate our pace of innovation. At our recent partner summit, we introduced a number of new technology solutions that help our customers adapt, accelerate and simplify their operations through new agile automation platforms.

Relative to our Infrastructure Platforms, our Cat 9K family of switches and Meraki cloud-based platforms continued to perform well, as our customers build highly secure, resilient and scalable networks as the foundation for their digital strategies. Our customers are also increasingly running applications across multiple cloud environments, and this requires next-generation architectures with automation security and insights.

We recently announced new cloud and SD-WAN platform innovations to help our customers connect, secure and automate across their hybrid environments with greater visibility into their applications.

We are making great strides with our webscale customers with our fourth consecutive quarter of strong double-digit growth. This reflects their belief in our strategy going forward and their ongoing commitment to invest with us to build out their future architectures.

We also continue to help our customers operate in a multi-cloud environment and optimize their overall cloud experience. In Q1, we extended these capabilities through

Cisco's Cloud On-Ramp solutions, which deeply integrate cloud services from AWS, Google and Microsoft to better enable end-to-end visibility and manageability of their distributed applications.

In Security, we delivered another solid quarter of growth driven by our broad cloud-native portfolio. SecureX, which offers a simplified security experience, saw strong adoption, as it has been deployed across more than 4,000 organizations since it became globally available in June.

As our customers' employees remain working from home, they are looking to bolster their existing security efforts with unified user and endpoint protection. We continue to benefit from the shift to cloud-based security capabilities and had robust growth in our secure remote worker offer that includes Duo, Umbrella and AnyConnect.

Our customers are also looking for highly secure, high-speed, low-latency connectivity to the internet. This is leading to the convergence of networking and security services in the cloud to securely connect any user or device to any application to provide the best experience.

Our world-class security team recently delivered new innovations, including Extended Detection and Response, Zero Trust and Secure Access Services Edge (SASE). By combining our leading solutions, SD-WAN and Umbrella, with our new secure internet gateway capabilities, our customers can deploy solutions to enable their users to simply and securely access cloud workloads and SaaS applications.

Moving to our Collaboration portfolio. Business continuity and resiliency remain top of mind for our customers. Organizations are focused on creating flexible work environments to drive productivity while ensuring their employees remain safe.

The future of work will be a hybrid model, with employees both in the office and at home, and we are leading in this area. Our collaboration portfolio is empowering organizations and teams to be more productive and secure as they adapt to new business, healthcare and learning models. We are providing seamless collaboration with anyone, anywhere, while enabling consistent experiences for hybrid workplaces and continuing our leadership in security.

Cisco Webex saw significant increased usage and solid adoption as customers looked to us for a flexible work solution that also enables privacy and security. Whether at home or in the office, our customers need a solution that brings together meetings, calling, file sharing and messaging with a simple and highly secure user experience. Last month alone, Webex had nearly 600 million participants, almost double the number we had in March.

We recently launched new return-to-office solutions that provide actionable workplace analytics with Webex Room Navigator and integrated collaboration device sensors that help ensure a safe working environment. We're also accelerating our innovation with new

offerings such as Webex Legislate to keep critical functions of global governments running, along with capabilities like breakout rooms, virtual huddle spaces and noise cancellation.

We are reimagining every aspect of the collaboration experience with built-in AI technology, security and integrated workflow applications to create a more intelligent work environment and to improve productivity.

Lastly, AppDynamics. Our customers are moving to highly distributed cloud-native applications, which require greater observability and insights. By combining AppDynamics and ThousandEyes, our cloud-based networking monitoring platform, we are delivering full-stack observability to help our customers better manage their applications and improve their digital experiences through end-to-end visibility, deep insights and automated action.

Now I want to share more on our CFO transition. On our last call, I shared that our CFO, Kelly Kramer, had decided to retire from Cisco. Today, I'm excited that Scott Herren will be joining Cisco as our new Executive Vice President and Chief Financial Officer beginning December 18.

Most recently, Scott served as the CFO for Autodesk. He brings an incredible background in software and helped lead Autodesk's successful business model transformation from perpetual licenses to SaaS and subscription software. As we continue our strong progress on our business model shift and sell more of our solutions as a service, Scott's depth of expertise in this area will help us accelerate our transition. He also has strong experience operating in complex global business environments at scale and a track record of profitable business growth, focused team-building and prudent financial controls. I have no doubt that he will contribute to and foster the culture we are all so proud of here at Cisco.

I want to thank Kelly once again for being such a great partner and for the role she has played in our transition. We will certainly miss her, but we're very excited to have Scott in this role and as part of our team.

In summary, we're encouraged by the start to the year. I'm proud of our progress, both in our transformation and in how we're empowering customers to accelerate their own digital strategies.

We have a clear vision and strategy, and I feel very good about our portfolio and the innovation we are driving. Our customers want partners they can trust as well as choice and flexibility in how they purchase, consume and implement technology based on their own individual needs. These anchors of trust, innovation and choice are core to who we are at Cisco.

As we focus on growing our business, we remain guided by our purpose to power an inclusive future for all. We know that pervasive access to technology and connectivity

directly impacts economic growth and enables key core human needs like healthcare and education. We know that technology can help solve some of the world's biggest challenges, and we are more committed than ever to building an inclusive future in which everyone can thrive.

I'll now turn it over to Kelly.

Financial Overview

Thanks, Chuck. I also want to congratulate Scott on his new role. I've had the chance to spend some time with him, and I'm super excited. I think this is a very positive move for Cisco and he will be a great addition to the team.

Also, thanks to you, Chuck. It's been a great time working with you over the years.

Now let me provide a summary of our financial results for the quarter followed by guidance for Q2.

Our overall Q1 results reflect good execution with strong margins in a challenging environment.

Total revenue was $11.9 billion, down 9% year-over-year. Our non-GAAP operating margin rate was 32.7%, down 0.9 points. Non-GAAP net income was $3.2 billion, down 11%, and non-GAAP EPS was $0.76, down 10%.

Let me provide more detail on our Q1 revenue.

Total product revenue was down 13% to $8.6 billion.

Infrastructure Platforms was down 16%, and as a reminder, this is the product area most impacted by the COVID environment. We saw declines across switching, routing, data center and wireless, driven primarily by the weakness we saw in the Enterprise and Commercial markets. We continued to see growth of the Cat 9K and the ramp of our Wi-Fi 6 products. Data center revenue declined, driven by servers.

Applications was down 8%; we did continue to see strong growth in Webex with the importance of remote working. This was offset by declines in Unified Communications and Telepresence endpoints.

Security was up 6%; our cloud security portfolio performed well, with strong double-digit growth and continued momentum with our Duo and Umbrella offerings.

Service revenue was up 2%, driven by growth in our maintenance business, as well as support services.

We continued to transform our business, delivering more software offerings and driving more subscriptions. Software subscriptions were 78% of total software revenue, up 7 points year over year.

Remaining performance obligations, or RPO, at the end of Q1 were $27.5 billion, up 10%. RPO for product was up 15% and service was up 8%. The continued growth in RPO demonstrates the strength of our portfolio in software and services.

In terms of orders in Q1, total product orders were down 5%. Looking at our geographies, the Americas was down 5%, EMEA was down 1% and APJC was down 14%. Total emerging markets were down 15%, with the BRICS plus Mexico down 19%. In our customer segments, Public Sector was up 5%, Enterprise was down 15%, Commercial was down 8% and Service Provider was down 5%.

From a non-GAAP profitability perspective, total Q1 growth margin was 65.8%, down 0.1 points. Product gross margin was 65.3%, down 0.8 points, and service gross margin was 67.1%, up 1.7 points year over year.

In terms of the bottom line from a GAAP perspective, Q1 net income was $2.2 billion and EPS was $0.51. GAAP results include restructuring charges of $602 million related to the plan we announced in Q1.

We ended Q1 with total cash, cash equivalents and investments of $30 billion. Operating cash flow was $4.1 billion, up 14%.

From a capital allocation perspective, we returned $2.3 billion to shareholders during the quarter that was comprised of $0.8 billion of share repurchases and $1.5 billion for our quarterly dividend.

Guidance

Let me reiterate our guidance for the second quarter of fiscal '21. This guidance is subject to the disclaimer regarding forward-looking information that Marilyn referred to earlier.

We expect revenue to be in the range of flat to minus 2% year-over-year.

We anticipate the non-GAAP gross margin rate to be in the range of 64% to 65%.

The non-GAAP operating margin rate is expected to be in the range of 32% to 33% and the non-GAAP tax provision rate is expected to be 19%.

Non-GAAP earnings per share is expected to range from $0.74 to $0.76.

Summary Comments

The first thing I'll say is that I'm really proud of our team and how hard they're working and how committed they are to our customers and making sure that we're taking care of them during these complex times, and obviously we're trying to take care of our employees during these complex times, but I really want to just focus on thanking Kelly. It's been an incredible partnership. We've had a lot of fun. And I think that there's a lot of love in the investor community for you. We're going to miss you, but we are excited about Scott. But Kelly, thanks for everything you've done for us.

No, I appreciate it, Chuck. It's been great working with you. And again, I do appreciate everybody on the Street, and it's been a great relationship. But Scott -- I think it's great that Scott's coming. He's going to be fantastic for the company. But thanks for everything, Chuck.

And Kelly actually helped us make that choice, so you guys can feel good that she helped us vet the candidates and was very supportive on Scott's -- on the decision for Scott. So thank you all for joining us today, and we'll look forward to talking to you again next quarter.

Closing

Thanks, Chuck. Thanks, Kelly. So in closing, Cisco's next quarterly earnings conference call, which will reflect our fiscal 2021 second quarter results, will be on Tuesday, February 9, 2021, at 1:30 p.m. Pacific time, 4:30 p.m. Eastern time.

Again, I'd like to remind the audience that in light of regulation FD, Cisco's policy is not to comment on its financial guidance during the quarter unless it is done through an explicit public disclosure.

We now plan to close the call, but if you have any further questions, feel free, as always, to reach out to the investor relations team, and we thank you very much for joining the call.

The prepared remarks set forth above and the related conference call may be deemed to contain forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among other things, statements regarding future events (such as improvement in our business as we continue to navigate the pandemic and other macro uncertainties, our ability to execute on our strategy to focus on winning with a differentiated innovative portfolio, long-term growth and being a trusted technology partner offering choice and flexibility to our customers, our future opportunities as every company in every industry is accelerating its digital-first strategy, our ability to continue to transform our business through more software offerings and subscriptions, and our ability to continue to deliver strong growth in operating cash flow and return value to our shareholders) and the future financial performance of Cisco (including the guidance for Q2 FY 2021) that involve risks and uncertainties. Readers are cautioned that these forward-looking statements are

only predictions and may differ materially from actual future events or results due to a variety of factors, including: the impact of the COVID-19 pandemic; business and economic conditions and growth trends in the networking industry, our customer markets and various geographic regions; global economic conditions and uncertainties in the geopolitical environment; overall information technology spending; the growth and evolution of the Internet and levels of capital spending on Internet-based systems; variations in customer demand for products and services, including sales to the service provider market and other customer markets; the return on our investments in certain priorities, key growth areas, and in certain geographical locations, as well as maintaining leadership in routing, switching and services; the timing of orders and manufacturing and customer lead times; changes in customer order patterns or customer mix; insufficient, excess or obsolete inventory; variability of component costs; variations in sales channels, product costs or mix of products sold; our ability to successfully acquire businesses and technologies and to successfully integrate and operate these acquired businesses and technologies; our ability to achieve expected benefits of our partnerships; increased competition in our product and service markets, including the data center market; dependence on the introduction and market acceptance of new product offerings and standards; rapid technological and market change; manufacturing and sourcing risks; product defects and returns; litigation involving patents, intellectual property, antitrust, shareholder and other matters, and governmental investigations; our ability to achieve the benefits of the announced restructuring and possible changes in the size and timing of the related charges; cyber-attacks, data breaches or malware; vulnerabilities and critical security defects; terrorism; natural catastrophic events; any other pandemic or epidemic; our ability to achieve the benefits anticipated from our investments in sales, engineering, service, marketing and manufacturing activities; our ability to recruit and retain key personnel; our ability to manage financial risk, and to manage expenses during economic downturns; risks related to the global nature of our operations, including our operations in emerging markets; currency fluctuations and other international factors; changes in provision for income taxes, including changes in tax laws and regulations or adverse outcomes resulting from examinations of our income tax returns; potential volatility in operating results; and other factors listed in Cisco's most recent report on Form 10-K filed on September 3, 2020. The financial information contained in the prepared remarks and the related conference call should be read in conjunction with the consolidated financial statements and notes thereto included in Cisco's most recent report on Form 10-K as it may be amended from time to time. Cisco's results of operations for the three months ended October 24, 2020 are not necessarily indicative of Cisco's operating results for any future periods. Any projections in the prepared remarks and the related conference call are based on limited information currently available to Cisco, which is subject to change. Although any such projections and the factors influencing them will likely change, Cisco will not necessarily update the information, since Cisco will only provide guidance at certain points during the year. Such information speaks only as of the date of the prepared remarks and the related conference call.