

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]
Q3FY22 Earnings Results Conference Call
Wednesday, May 18, 2022

Introduction

Welcome, everyone, to Cisco's Third Quarter Fiscal 2022 Quarterly Earnings Conference Call. This is Marilyn Mora, Head of Investor Relations, and I'm joined by Chuck Robbins, our Chair and CEO; and Scott Herren, 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.

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 we'll 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 done on a year-over-year basis. Please note, included in the materials that accompany this call is a slide which summarizes the impacts from the war in Ukraine and the extra week in Q3 fiscal 2021.

The matters we will be discussing today include forward-looking statements, including the guidance we will be providing for the fourth quarter and full year of fiscal 2022. 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 reports on Forms 10-K and 10-Q, which identify 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.

I will now turn it over to Chuck.

Opening Remarks

Thanks, Marilyn, and good afternoon, everyone.

When we spoke with you back in February, we entered Q3 in the second half of our fiscal year with optimism despite the supply and component challenges and other headwinds impacting us and many of our peers. Many of those factors that fuel that optimism remain unchanged today. We continue to see strong demand, resulting in record backlog. Our business transformation is progressing well. And our differentiated innovation across our portfolio is helping our customers embrace and adopt the multiple technology transitions happening.

However, there were two unanticipated events since our last earnings call which impacted our Q3 revenue performance.

The first is the war in Ukraine. This resulted in us ceasing operations in Russia and Belarus and had a corresponding revenue impact, which Scott will discuss.

The second relates to COVID-related lockdowns in China, which began in late March. These lockdowns resulted in an even more severe shortage of certain critical components. This in turn prevented us from shipping products to customers at the levels we originally anticipated heading into Q3.

Our Q4 guidance incorporates a wider than usual range, taking into account the revenue impact of the war in Ukraine and the continuing uncertainty related to the China COVID lockdowns. Given this uncertainty, we are being practical about the current environment and erring on the side of caution in terms of our outlook, taking it one quarter at a time.

We believe that our revenue performance in the upcoming quarters is less dependent on demand and more dependent on the supply availability in this increasingly complex environment.

While certain aspects of the current situation are largely out of our control, our teams have been working on several mitigation actions to help alleviate many of the component issues that we've been facing. We believe that we will begin to see the benefits of these actions in the first half of next fiscal year.

Now let me talk more specifically about our third quarter performance. As I just mentioned, many of the positives we've discussed over the past few quarters remain, resulting in continued solid demand for our solutions. Total product orders grew 8% year-over-year, leading to yet another record backlog of well over \$15 billion, up 10% sequentially and up 130% year-over-year. This momentum reaffirms the critical role we play in our customers' futures.

Our business transformation also progressed nicely. In Q3, we saw ARR growth of 11%, ending the quarter at over \$22 billion and product ARR growth of 18%. We also exited the quarter with over \$30 billion in remaining performance obligations, or RPO.

We also delivered non-GAAP EPS at the high end of our guidance range. This was driven by effective pricing actions and spending discipline, all of which allowed us to offset lower volumes and deliver both gross and operating margins above the high end of our guidance range and deliver on our bottom-line profitability target for the quarter.

I want to reiterate what I said earlier. The fundamental drivers across our business are strong. While we are facing some short-term challenges, it does not change our long-term outlook, our alignment to our customers' most critical challenges or our belief in the tremendous opportunities in front of us.

Last week, we hosted our Global Customer Advisory Board meeting, where we met with close to 100 customers. And they consistently shared that technology is at the heart of their strategy and has become even more important to everything they do. It's driving not just their strategies, but also their overall business transformation. The technology they are adopting from Cisco is driving their business agility, allowing them to move with greater speed and empowering them to deliver differentiated experiences for their customers.

Now I'd like to touch on some highlights from the quarter.

We continue to see strong demand in several areas of our business.

Our webscale business remains strong as we continue to help these customers build their capabilities to connect and serve their customers and end users at scale from the data center to the edge. This is leading to continued strength in orders, which grew over 50%. And on a trailing four-quarter basis, we had over 100% growth. This marks our ninth consecutive quarter of solid demand as we are winning new franchises, expanding our design wins and taking share in web scale. I remain incredibly proud of the progress we've made and the momentum we have in this space.

We are also extremely pleased with the traction of our 400G solutions, including the Cisco 8000, which is the fastest growing SP routing platform in Cisco's history. In addition, our SiliconOne portfolio, ZR and ZR+ optics and our Acacia portfolio of optical networking products also continue to perform well.

From a product revenue perspective, our performance was led by solid demand across a majority of our portfolio, including switching, SP routing, wireless, security and SDWAN. Our performance in these areas reflect the ongoing investments that our customers are making to rapidly digitize their organizations to deliver differentiated experiences.

Looking forward, the shift to hybrid cloud, 5G, 400G, IoT, hybrid work and the explosion of applications are driving the increased need for next-generation networking, connectivity, security and observability solutions. Cisco is well positioned to deliver for our customers with our end-to-end platforms and solutions.

I'm also very proud of our pace of innovation. During the quarter, Cisco announced new innovations across our networking and cloud portfolios, along with technologies to enhance

experiences in hybrid work environments. We also introduced our new Predictive Networks to help organizations learn, predict and avoid network disruptions. We have even more innovation, which we'll announce at RSA and our own Cisco Live event in June.

In addition to our deep passion for innovation, all of us at Cisco believe we have a unique opportunity to help make the world a better place through both the technology we build and the purpose we rally around to power an inclusive future for all. I believe this intersection of technology and purpose is why we were named the #1 Best Company to Work for in the U.S. by Fortune and Great Place to Work for the second year in a row.

In summary, while the quarter clearly did not play out as expected, demand remains solid and the fundamentals of our business are strong. We remain focused on executing against the strategy we laid out at our Investor Day. We will also continue to be resolute in our focus to transform our business for more predictability and agility while bringing to market a robust pipeline of innovation. We remain confident in our long-term growth and the opportunities that we have in front of us.

I want to thank our teams around the world for all that they do, executing with dedication, focus and excellence in an incredibly dynamic environment. They continue to focus on our customers with unparalleled innovation, resiliency and determination.

And with that, I'll now turn the call over to Scott.

Financial Overview

Thanks, Chuck.

We saw solid growth in product orders, net income and earnings per share despite the challenges Chuck just outlined. Product order growth was driven by strength across most of our portfolio, while disciplined spend and supply chain management drove our profitability.

Total revenue was \$12.8 billion, flat year-over-year. Our non-GAAP operating margin was 34.7%, up 110 basis points, coming in above the high end of our guidance range. Non-GAAP net income was \$3.6 billion, up 3%. And non-GAAP earnings per share was \$0.87, up 5%, coming in at the high end of our guidance range.

In March, we stopped business operations in both Russia and Belarus, which had a negative impact to revenue of approximately \$200 million, or 2 percentage points of growth. Historically, Russia, Belarus and Ukraine collectively have represented approximately 1% of our total revenue. The impact this quarter was a bit higher than our historical run rate due to additional charges to revenue we recorded for uncollectible receivables and other items. And as a reminder, Q3 of last year included an extra week, which was a benefit to total revenue in Q3 of '21 of approximately 3 full percentage points of growth. On a combined basis, the impact of the year-over-year total revenue growth rate for the extra week and the war in Ukraine was approximately 5 percentage points.

Looking at our Q3 revenue in more detail.

Total product revenue was \$9.4 billion, up 3%.

Service revenue was \$3.4 billion, down 8%, driven by the extra week in the prior year and the war in Ukraine, which combined impacted our growth by approximately 8 percentage points.

Within product revenue, Secure Agile Networks was solid with revenues up 4%. Switching grew driven by strength in data center switching with our Nexus 9000 products. Campus switching growth was led by our Catalyst 9000 and Meraki switching offerings. Wireless had a double-digit increase, driven by broad-based strength across our portfolio, including our WiFi 6 products and Meraki wireless offerings. We also had solid growth in servers. Enterprise routing declined, primarily driven by Edge and Access, slightly offset by strength in SD-WAN.

Internet for the Future was up 6%, driven by strength in Acacia, Optical, Optics and Core networking products, including double-digit growth in the Cisco 8000.

Collaboration was down 7%, driven by declines in our Meetings, Calling and Contact Center offerings, partially offset by the continued ramp of our Communication Platform as a Service.

End-to-End Security grew 7% with broad strength across most of the portfolio. Our Zero Trust portfolio performed well with double-digit growth driven by strong performance in our Duo offering.

Optimized Application Experiences was up 8%, driven by double-digit growth in both of our SaaS-based offerings, ThousandEyes and Intersight.

We continue to make progress on our transformation metrics as we shift our business to more subscriptions and software.

Total software revenue was \$3.7 billion, a decrease of 3%, with the product portion down 1%. Total software revenue growth would have been 5 points higher, excluding the combined negative impact of the extra week in the prior year and the war in Ukraine. 83% of software revenue was subscription-based, which is up 1 percentage point year-on-year.

Total subscription revenue was \$5.5 billion, a decrease of 4%. Total subscription revenue would have been 7 points higher, excluding the combined negative impact of the extra week in the prior year and the war in Ukraine. Total subscription revenue represented 43% of Cisco's total revenue.

Annualized recurring revenue, or ARR, was \$22.4 billion, an increase of 11%, with strong product ARR growth of 18%.

And remaining performance obligations, or RPO, was \$30.2 billion, up 7%. Product RPO increased 13%. Service RPO increased 3%, and the total short-term RPO grew 9% to \$16.2 billion.

We had solid product order growth in Q3 of 8% with strength across most of the business.

Looking at our geographic segments. The Americas was up 9%, EMEA up 4% and APJC up 11%. In our customer markets, Commercial was up 19%, Service Provider was up 8%. Public Sector was up 4% and Enterprise was flat.

From a non-GAAP perspective, total gross margin came in above the high end of our guidance range at 65.3%, down 70 basis points year-over-year. Product gross margin was 64.1%, down 80 basis points. And Service gross margin was 68.9%, up 20 basis points. The decrease in product gross margin was primarily driven by ongoing higher component costs related to supply constraints as well as higher freight and logistics costs, partially offset by strong positive pricing impact.

We continue to manage through the supply constraints seen industrywide by us and our peers.

To give a sense of scale of the shortages, we currently see constraints in Q4 on roughly 350 critical components out of a total of 41,000 unique component part numbers. Our supply chain team is aggressively pursuing multiple options to close those shortages.

Given our solid product orders, we once again saw a significant increase in our backlog levels for both hardware and software well beyond our normal historical levels. As Chuck said, our ending product backlog grew to well over \$15 billion, and software backlog grew to more than \$2 billion, both up 10% sequentially. And just a reminder, backlog is not included as part of our \$30.2 billion in remaining performance obligations.

We ended Q3 with total cash, cash equivalents and investments of \$20.1 billion. Operating cash flow for the quarter was \$3.7 billion, down 6% year-over-year, primarily driven by advanced payments to secure future supply. These advanced payments had a negative 9 percentage point year-on-year impact on Q3 operating cash flow.

In terms of capital allocation, we returned \$1.8 billion to shareholders during the quarter that was comprised of \$1.6 billion for our quarterly cash dividend and approximately \$250 million of share repurchases. Year-to-date, we have returned a total of approximately \$10 billion in value to our shareholders via cash dividends and stock repurchases and have more than \$17 billion available under our Board stock repurchase authorization.

To summarize, we're navigating the highly complex environment while continuing to make progress on our business model shift and making strategic investments in innovation to capitalize on our significant growth opportunities and expanding addressable markets.

Guidance

Now let me provide our financial guidance for Q4. In terms of supply, we expect the challenges we experienced in Q3 to continue into Q4.

For next quarter, we expect revenue growth to be in the range of minus 1% to minus 5.5%. We anticipate the non-GAAP gross margin to be in the range of 64% to 65%.

Our non-GAAP operating margin is expected to be in the range of 31.5% to 33.5.

Non-GAAP earnings per share is expected to range from \$0.76 to \$0.84.

For the full year of fiscal '22, guidance is as follows.

We expect revenue growth to be in the range of 2% to 3% year-on-year.

Non-GAAP earnings per share guidance is expected to range from \$3.29 to \$3.37, up 2% to 5% year-on-year.

In both our Q4 and full year guidance, we're assuming a non-GAAP effective tax rate of 19%.

Summary Comments

So first of all, I want to thank everybody for spending time with us and diving into the complex situation that we face. It's clearly a dynamic and challenging environment. We clearly faced unanticipated events during Q3 with the COVID lockdowns and the war in Ukraine. We think the short-term challenges that we will manage through, our teams have been working really hard on these mitigation actions that we believe will begin to benefit us in the first half of our next fiscal year, which is good. We're successfully realizing price increases, which is good.

And also in Q3, even though we had a miss on the top line, I just want to point out that it was a record EPS quarter for us as a company. And at the low point of our guidance for Q4, we will deliver record EPS for the full year. So while the top line is disappointing, we have navigated this complex year and actually will deliver solid EPS when we're done.

The fundamentals are strong, a lot is still in our favor, demand. Business transformation is working, the technology transitions and the number that we're participating in. We have great teams around the world, and that leads me to have a high degree of confidence despite the short-term challenges that we face.

So thank you all for spending time with us, and we look forward to connecting with you next quarter.

Closing

Thanks, Chuck. And I'll just wrap it up by saying Cisco's next quarterly earnings conference call, which will reflect our fiscal fourth quarter and fiscal 2022 results, will be on Wednesday, August 17, 2022, at 1:30 p.m. Pacific Time, 4:30 p.m. Eastern Time.

So this concludes today's call. But if you have any further questions, feel free to reach out to the Investor Relations team. And we thank you very much for joining us today.

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 our ability to manage through ongoing supply constraints, the success of our strategy and confidence in our long-term growth, the fundamental drivers across our business being strong, the strong demand resulting in record backlogs, our business transformation shifting to more software and subscriptions, and our strategic investments in innovation to capitalize on significant growth opportunities and expanding addressable markets) and the future financial performance of Cisco (including the guidance for Q4 FY 2022 and full year FY 2022) 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 and related public health measures; 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 Secure, Agile Networks and services; the timing of orders and manufacturing and customer lead times; significant supply constraints; 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, other intellectual property, antitrust, stockholder and other matters, and governmental investigations; our ability to achieve the benefits of restructurings and possible changes in the size and timing of related charges; cyber-attacks, data breaches or malware; vulnerabilities and critical security defects; terrorism; natural catastrophic events (including as a result of global climate change); 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 reports on Forms 10-Q and 10-K filed on February 22, 2022 and September 9, 2021, respectively. The financial information contained in the prepared remarks and the related conference call should be read in conjunction with the consolidated financial statements and notes thereto included in Cisco's most recent reports on Forms 10-Q and 10-K as each may be amended from time to time. Cisco's results of operations for the three and nine months ended April 30, 2022 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.

