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]
Q4FY22 Earnings Results Conference Call
Wednesday, August 17, 2022

Introduction

Welcome, everyone, to Cisco's Fourth 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.

The matters we will be discussing today include forward-looking statements, including the guidance we will be providing for the first quarter and full year of fiscal 2023. They are subject to the risks and uncertainties 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

Thank you, Marilyn, and thanks to all of you for joining us today. I'm very proud to share that we had a strong end to our fiscal year in the midst of an incredibly dynamic environment. In fact, we set several records with our performance this year.

Let me first touch on those. For the full year of fiscal '22, we delivered record non-GAAP EPS of $3.36, record product orders which fueled our backlog to the highest level ever recorded, as well as our second-strongest year of revenue in the history of the company at $51.6 billion.

We continue to see strong customer adoption of our software and subscriptions driven by the targeted investments we've been making. We also had record net income, which reflects our operating discipline despite external challenges, including supply chain and inflation.

Our ongoing business transformation continues to show progress across our KPIs, with Annualized Recurring Revenue, or ARR, and Remaining Performance Obligations, or RPO, both setting record highs. These important metrics illustrate the increasing recurring nature of our revenue streams. This, combined with our record backlog, provides us with enhanced visibility into our business looking forward.

While this was certainly a complex year, we executed well. I want to thank our teams for their perseverance, determination and unwavering commitment to our customers and our partners.

Our team's commitment to accelerated innovation has put us in a unique position of strength for fiscal '23 and over the long-term. Now I want to be clear on our outlook for fiscal '23. We expect strong performance across our portfolio, driven by our continued focus on innovation and easing of supply constraints to drive solid top line growth and profitability. While we anticipated some moderation from the unprecedented product order growth of last year, demand signals remained solid. We do expect to continue to experience higher costs in the short term, driven primarily by higher component, freight and logistics costs, which is reflected in our Q1 guide. However, as you'll see in our annual guidance, we expect this margin pressure to begin to ease as the year progresses.

Long-term, there are many multiyear growth opportunities ahead of us that gives me confidence in our future. There are currently more technology transitions occurring concurrently than I've seen in 20 years. Long-term megatrends like hybrid cloud, hybrid work, security, IoT, 400G and beyond, 5G and WiFi 6, as well as the move toward application observability, will likely provide tailwinds to our growth. With our portfolio in such a strong position to help our customers, I'm quite optimistic about what's ahead.

Before we discuss the quarter in detail, I want to provide some additional color on the supply situation and how we continue to build greater resiliency.

After a challenging April due to the COVID-related shutdowns in Shanghai and the impact on semiconductor and power supplies, overall supply constraints began to ease slightly at the back half of the fourth quarter and continuing into the start of Q1. While the component supply headwinds remain, they have begun to show early signs of easing.

The decisions we made and the multiple actions we have taken over the past two years are helping to improve our resiliency and will help offset cost inflation. These include adding new suppliers, leveraging alternative suppliers, redesigning hundreds of products to use alternative components with similar capability, and targeted price increases, all of which position us for the future. These actions, along with the tremendous efforts by our supply chain team and the investments we've made in building capacity to meet growth, have the potential to drive momentum into fiscal '23.

Moving to performance highlights in the quarter. We delivered revenue above the high end of our guidance range and non-GAAP EPS came in at the high end of our guidance range.

We achieved healthy operating margins and generated solid cash flow and returned nearly $4 billion to Cisco stockholders through cash dividends and share repurchases.

With annual product order growth of 14% for the fiscal year, we exited the year with record product backlog. In addition, our RPO totaled more than $31 billion, and when combined with low cancellation rates, which remain below pre-pandemic levels, this sets the stage for increased visibility and strong revenue growth as we head into fiscal '23.

In terms of our product orders this quarter, we delivered the second highest orders in absolute dollars in the history of the company. It was second only to our performance in Q4 of fiscal '21, and on a sequential basis, it was up greater than 15%, with strong growth in Enterprise, Commercial and Public Sector.

From an annual growth rate perspective, we clearly faced some very tough comparisons from the record orders we saw in Q4 last year, where we had over 30% growth. Based on that, the year-over-year decline was not a surprise, nor is it concerning.

It's important to keep in mind that in the near term, the rate and pace of our revenue growth is much more a function of component availability than on our quarterly product order growth. With RPO of over $31 billion, almost $17 billion of which will be recognized as revenue over the next 12 months, and a record backlog, we have great top line visibility. Thanks to the relentless effort of our entire organization, the business remains stronger than before the pandemic.

From a demand perspective, we continue to experience solid customer activity beyond our ability to deliver, as is reflected in the growth of our backlog that we saw throughout the quarter.

While our business is not immune to macro trends, we will remain disciplined in our operations while benefiting from robust multiyear investment trends and the technology transitions I mentioned earlier. Our innovation is helping our customers and partners navigate an increasing amount of complexity, and there is a greater sense of urgency to leverage leading-edge technologies to deliver on their strategic objectives. This is leading them to consistently look to Cisco and our unique and differentiated innovation to help them advance their most pressing business priorities.

We recently held our Cisco Live customer event in person for the first time in three years and had over 15,000 in attendance, including thousands of our largest customers, and many more participating virtually. Our discussions with them focused on strategic projects, supply insurance and the critical role Cisco can play to support their long-term technology roadmaps. They do not indicate any fundamental shift in their commitment to technology investments.

Regardless of what the coming quarters may bring, we have a proven track record of being able to adjust in difficult environments. Our value proposition to our customers remains as strong as ever.

In our Webscale business, we continue to see momentum even as the business becomes larger, as product orders were up more than 50% on a trailing-four-quarter basis. We see significant opportunity ahead as these customers build out massively scalable cloud networks and increasingly turn to Cisco to help them meet accelerating demand for cloud services.

Our leadership in silicon, optics, software and systems enables us to win as hyperscalers value industry-leading performance and innovation. We are expanding our footprint, driven by data center buildouts with our Silicon One-based Cisco 8000 routers, the fastest-growing platforms in Cisco's history. Together with optics from Acacia, we have a strong foundation for 400G and beyond to rearchitect the internet with routed optical networking. In addition, we recently booked and shipped our first 800G systems to one of our webscale customers.

On the IoT front, we also now have more than 200 million connected things on our cloud platform, with growth driven by connected car. We finished fiscal '22 with product orders in excess of $1 billion and growing double digits.

We continue to make progress on our transformation to more software and subscription-based recurring revenue. ARR of approximately $23 billion was up 8%, with product ARR increasing by 13%.

We had strong subscription revenue this quarter, driven by our growing portfolio of recurring offers. While our software revenue was down slightly, once supply constraints improve and we begin to increase product shipments, we expect to see an improvement in software, subscription and services that are attached to hardware products in our backlog.

The investments we've made in innovation are paying off as our competitive position is very strong. In Q4, we introduced several new cloud-delivered innovations across our portfolio to help organizations drive productivity and resiliency. We launched Nexus Cloud, a platform to help our customers deploy, manage and operate their data center networks from the cloud. In addition, we introduced Calisti and Panoptica, two new cloud-native API-first tools for faster and better application development. We also announced AppDynamics Cloud, a next-generation version of our observability platform for cloud-native applications.

In addition, we shared our strategy to help our customers connect their entire security architecture with our new platform, Cisco Security Cloud, which will be a game-changer for them as they look to secure their multicloud environments with a single cloud-delivered security

platform. This is just one part of our broader security innovation cycle. Building on the double-digit growth we saw in security this quarter, we are investing across our security business, focusing on cloud-based offerings, best-in-class AI-driven threat detection and end-to-end security architectures. These innovations position us well for leadership in the security market.

In summary, we executed well on our strategy and transformation during what remains a very dynamic time. This led to a strong close to our fiscal year, setting several records across our business, thanks to the solid execution from our teams, our market-leading innovation and our continued growth of recurring revenue. We also took decisive actions to help offset inflation and build resiliency in our supply chain while investing in our business to position us well for long-term growth.

The power of our technology continues to be a critical driver of economic growth and productivity. Our results and outlook demonstrate the critical role that Cisco plays as a leader in bringing innovative technology solutions to customers today and into the future.

As we move into fiscal '23, we remain guided by our purpose-led culture and deeply committed to delivering value for our customers, partners and investors, as well as continuing to be an amazing place to work for our employees.

I will now turn it over to Scott.

Financial Overview

Thanks, Chuck. I'll first provide some detail on our financial results for the quarter, then cover the full fiscal year, followed by our guidance.

Our overall Q4 results reflect strong execution in an environment with continuing supply constraints, and as Chuck mentioned, increased costs reflected in our gross margins. We were very pleased that our shipment levels were above our expectations and that total revenue of $13.1 billion exceeded the high end of our guidance range, as we saw improvement in supply as a direct result of the numerous actions we've taken over multiple quarters.

Our non-GAAP operating margin was 32.4%, down 110 basis points and in line with our guidance. Non-GAAP net income was $3.4 billion, down 3%, and non-GAAP earnings per share was $0.83, coming in at the high end of our guidance range.

Looking at our Q4 revenue in more detail:

Total product revenue was $9.7 billion and service revenue was $3.4 billion, both flat year-over-year.

Within product revenue, Secure, Agile Networks was down 1%. Switching declined in both data center and campus, driven by supply constraints. We saw growth in our Catalyst 9000, Nexus 9000 and Meraki switching offerings. Enterprise routing declined, primarily driven by Edge and

SD-WAN, offset by strength in Access. Wireless had strong growth, driven primarily by our Meraki wireless offerings. We also had double-digit growth in servers.

Internet for the Future was down 10%, with strength in web scale revenue offset by declines in Cable, Edge and Optical.
Collaboration was up 2%, driven by growth in Collaboration Devices, partially offset by declines in our Meetings and Calling offerings.

End-to-End Security had record revenue, with strong growth of 20% driven by strength across the entire portfolio. Our zero-trust portfolio continues to perform well, driven by strong performance in our Duo offering.

Optimized Application Experiences had solid growth of 8%, driven by double-digit growth in our SaaS-based offering ThousandEyes.

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

We saw strong performance in our ARR of $22.9 billion, an increase of 8%, with product ARR growth of 13%, driven by several large software transactions closing during the quarter.
Total software revenue was $3.9 billion, a decrease of 2%, with software subscription revenue up 1%. Bear in mind, we continue to have well over $2 billion of software orders in our product backlog. 83% of the software revenue was subscription-based, which is up 2 percentage points year-over-year.

Total subscription revenue was $5.8 billion, an increase of 2%. Total subscription revenue represented 44% of Cisco's total revenue.

And RPO was $31.5 billion, up 2%. Product RPO increased 6%, service RPO decreased 1% and our total short-term RPO grew 4% to $16.9 billion.

Total product orders in Q4 were the second highest in our history. While product orders were down 6% for the quarter, it's important to keep in mind that they compare against 31% growth a year ago, which was the highest product orders in our history. On a sequential basis, product order growth was up over 15%, with double-digit growth in Enterprise, Commercial and Public Sector.

Looking at our geographic segments year-over-year, the Americas was down 9%, EMEA down 4% and APJC up 1%. In our customer markets, Enterprise was down 15%, Public Sector was down 3%, Service Provider was down 7% and Commercial was up 1%.

From a non-GAAP perspective, total gross margin came in at 63.3%, down 230 basis points year-on-year. Product gross margin was 61.3%, down 370 basis points, and service gross margin was 69%, up 160 basis points. In our product gross margin, higher component and commodity costs, as well as higher freight and logistics related to supply constraints, were the predominant

drivers of lower-than-expected margins. We saw increased benefits from the pricing actions we have taken as well as from mix.

Once again, we had 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 was a record for the year, and just a reminder, backlog is not included as part of the $31.5 billion in remaining performance obligations.

It's important to note that the combined total of our backlog and RPO gives us great visibility into our fiscal '23 top line growth.

We ended Q4 with total cash, cash equivalents and investments of $19.3 billion. Operating cash flow for the quarter was $3.7 billion, down 18% year-over-year, primarily driven by advance payments and inventory purchases to secure future supply.

In capital allocation, we returned $4 billion to shareholders during the quarter. It was comprised of $2.4 billion of share repurchases and $1.6 billion for our quarterly cash dividend.

Turning to the full fiscal year results. Overall, our financial results were solid in a year where we faced significant supply constraints, rising component and related costs and the war in Ukraine. Our financial performance was highlighted by strong demand, with product order growth of 14%, including two quarters of truly impressive 33% growth, though our performance was clearly impacted by the supply constraints. Revenue was $51.6 billion, up 3%, while non-GAAP earnings per share were up 4% at $3.36.

In terms of our software metrics:

Total software revenue was flat at $15.1 billion, with the product portion up 2%. 81% of software revenue was subscription-based, which is up 2 percentage points year-on-year.

Total subscription revenue was $22.4 billion, an increase of 2%, and total subscription revenue represented 43% of Cisco's total revenue.

Total non-GAAP gross margin was 64.6%, down 150 basis points, and our non-GAAP operating margin was 33.6%, up 10 basis points. On the bottom line, non-GAAP net income was $14.1 billion, up 3%. We delivered operating cash flow of $13.2 billion, down 14% compared to fiscal '21, driven primarily by advance payments for inventory purchases to secure component supply. While these payments had a negative impact on full year operating cash flow, these and our other related actions helped to improve the supply situation in Q4 and future quarters.

From a capital allocation perspective, we returned approximately $14 billion in value to our shareholders via cash dividends and stock repurchases, representing 109% of our free cash flow. This was comprised of $7.7 billion of share repurchases and $6.2 billion in quarterly cash dividends. We also increased our dividend for the 11th consecutive year in fiscal '22, reinforcing our commitment to returning excess capital to our shareholders and our confidence in the

strength and stability of our ongoing cash flows. Our strong balance sheet and overall financial position is clearly a competitive advantage in tough environments.

To summarize, we executed well in Q4 and had a solid fiscal year in a 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. The demand for our products and services is strong as we drive innovation through continued investment and the shift to more recurring revenue, delivering growth and driving shareholder value.

Guidance

Turning to our financial guidance for Q1:

We expect revenue growth to be in the range of 2% to 4%.

We anticipate non-GAAP gross margin to be in the range of 63% to 64%.

Our non-GAAP operating margin is expected to be in the range of 31.5% to 32.5% and non-GAAP earnings per share is expected to range from $0.82 to $0.84.

For fiscal '23, our guidance is as follows:

We expect revenue growth to be in the range of 4% to 6% year-on-year.

Non-GAAP earnings per share guidance is expected to range from $3.49 to $3.56, also up 4% to 6% year-on-year.

In both our Q1 and full year guidance, we're assuming a non-GAAP effective tax rate of 19%.

Summary Comments

Well, thank you all. Before we wrap, I want to make a few closing comments. I just first want to say I'm really proud of what our teams have achieved. It's obviously a very dynamic environment and the teams have really shown great execution and great focus.

We did have tough compares, and so we worked really hard to try to give you a different way of looking at the demand, and we'll just -- we'll let you know if we see anything change when we come back together in the next call, but right now, demand remains solid. I think customers really do understand the value that technology brings to their strategy.

I also appreciate what our supply chain teams have achieved, and we're encouraged by what we're seeing and how that supply hopefully will continue to ease throughout the year.

The business model transition is really helping us give you more visibility and predictability, and I'm also proud of how our team has rallied around our purpose.

Just a couple of comments: This year, we set another record, a record-high number of employees who are giving back into their communities. Our net zero by '24 target and nearer-term targets were just approved by the Science-Based Targets initiative under its net zero standard. So we're not only committed to our own goals, but also building technology that helps our customers meet their own goals. Lastly, we've been named the #1 Great Place to Work in 20 countries around the world, and on any day, I would be proud of that, but this is super important right now given the competition for talent around the world, and it really does make a difference when we're trying to hire new talent into the organization. It really makes us more resilient than ever, and I think we're well positioned for long-term growth.

And I want to thank all of you for spending time with us today. Thank you.

Closing

Thanks, Chuck. So I'll go ahead and close out the call. Cisco's next quarterly earnings call, which will reflect our fiscal year 2023 first quarter results, will be on Wednesday, November 16, 2022, at 1:30 p.m. Pacific Time, 4:30 p.m. Eastern Time.

This concludes today's call. If you have any further questions, feel free to contact the Cisco Investor Relations group, and we thank you very much for joining today's 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 our ability to execute in an incredibly dynamic environment, the success of numerous initiatives we have taken to reduce the impact of the global supply situation, the success of our strategy and confidence in our long-term growth, the fundamental drivers across our business being strong, strong demand for our innovation and the solutions we bring to our customers as they accelerate their digital transformation resulting in record backlogs, continued progress on our business model transformation shifting to more software and subscriptions, and our commitment to returning excess capital to our shareholders and confidence in our ongoing cash flows) and the future financial performance of Cisco (including the guidance for Q1 FY 2023 and full year FY 2023) 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 May 25, 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 months and the year ended July 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.