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]
Q4 and FY21 Earnings Results Conference Call
Wednesday, August 18, 2021

Introduction

Welcome everyone to Cisco's Fourth Quarter Fiscal 2021 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 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 made 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 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.

With that, I will now turn it over to Chuck.

Opening Remarks

Thank you, Marilyn, and good afternoon, everyone. I hope you're all remaining healthy and staying safe.

Our team at Cisco ended fiscal 2021 with an incredibly strong finish. We had an outstanding Q4 performance and fiscal year revenue reflecting strength across our portfolio, customer segments and geographies. Our product order growth was the highest we've seen in over a decade, and we're continuing to see strong customer reception to the accelerated investments in software and subscriptions. This great momentum is reaffirming our position as the worldwide leader in technology that powers the internet and a digital enterprise.

As I think about our achievements over the past year, three things stand out to me.

First, the exceptional execution of our teams. We achieved these results through the extraordinary efforts of our leadership team, our partners, and most importantly, our people around the world, who operated with incredible speed and at an unprecedented scale to deliver this growth.

Second, our transformation and strategic investments are paying off. The benefits of our shift to software and subscriptions are clear, and they are helping both Cisco and our customers move with greater speed and agility.

And third, the power of our portfolio. The groundbreaking innovation we are investing in today will serve as the foundation for our customers' futures.

These three factors position us exceptionally well for growth as we enter our next fiscal year, as evidenced by our results this quarter. We are more confident than ever that we are in a strong position to help our customers be successful.

As we look forward, we are laser focused on providing our customers the technologies they will need to successfully navigate highly dynamic environments at an incredibly rapid pace. With the rise of COVID variants and the inconsistent pace of vaccine deployment around the globe, organizations must be resilient and adaptable, as we've seen how quickly the world around us can change. While this may impact certain short-term plans like return to office for many, one thing is clear: There is tremendous demand for Cisco's technology.

No matter how or when the global recovery takes shape, we are executing on our vision of rebuilding a better world; one that is digital, sustainable, inclusive, and highly secure.

I believe we're at a pivotal moment in our company's history, as we have a massive opportunity to transform what has been the traditional office and define the future of hybrid work. As our customers look to create safer hybrid workplaces as well as collaborative and engaging experiences for their customers and employees, we believe they are becoming increasingly reliant on Cisco technologies to help them with their transformation and resiliency.

Enterprises are increasingly seeking digital and cloud-enabled services, which is driving demand for our solutions and leading to new and expansive market opportunities for Cisco. We're in a unique leadership position to build and deliver innovative cloud-to-edge infrastructure platforms that our customers need. With the depth and breadth of our hardware, software, silicon, and optics solutions, we are helping companies solve their biggest challenges. Whether it's adopting modern application architectures, shifting to hybrid work and hybrid cloud, securing their enterprise or meeting their ESG goals, Cisco is helping our customers thrive in a hybrid world.

These industry dynamics help drive our strong fourth quarter performance.

The momentum we saw in Q3 accelerated through Q4 as we delivered robust revenue growth, increased earnings, strong margins, and record operating cash flow. We also generated strong double-digit growth in product deferred revenue, reflecting the success of our transformation around driving subscriptions and recurring revenues, which increases our visibility into future performance.

We are seeing IT budgets grow as companies begin to implement their critical future plans and business confidence increases. However, we do recognize that uncertainty remains around COVID-19, and we are closely monitoring the Delta variant and its impact on customer spending. Right now, we are not seeing any additional impact to our business aside from the components shortage we've been facing over the past several months.

Moving to the performance of our customer segments. As I mentioned, we delivered the highest product order growth in over a decade with growth of 31%, driven by strength across all of our end markets. This outstanding performance is also up over 17% from our pre-COVID Q4 levels in fiscal year 2019. We saw double-digit growth in every one of our customer segments. This strength is being driven by stronger customer investment in substantial network upgrades to help modernize and secure their environments to support the new way of working.

Specifically, in our Enterprise business, we had the best quarter in terms of product orders in over a decade and saw very strong order growth of 25%. We also had our third consecutive quarter of acceleration in our Commercial, Service Provider and Public Sector businesses with all of these segments showing growth in excess of 20%.

In our webscale business, we saw increased momentum, delivering record performance, with over 160% order growth, and on a trailing four-quarter basis, orders grew over 80% due to customers adopting products across the portfolio and early traction of our 400G solutions, a huge testament to the investments we have made in accelerating innovation and the differentiated value we're bringing to these customers.

From a product portfolio perspective, we also had a very balanced performance. As customers prepare for office reopenings and hybrid work, they are increasing their investment across our networking, cloud security and unified communications portfolios. In Q4, we saw double-digit revenue growth in Campus Switching, Catalyst 9000, High End Routing, Wireless and in our Zero Trust solutions, along with strength in our security endpoint portfolio. We also had very strong adoption of our Acacia optical solutions, driven by increasing customer demand for leading edge technology to address their growing bandwidth requirements.

The transformation of our business to more software and subscriptions continues to show tremendous progress, as we achieved over $4 billion in software revenue in Q4, an increase of 7% sequentially and up 6% year-over-year. Within that, subscription revenue grew 9% in Q4 and

15% for the full fiscal year. For perspective, software represented 31% of our business in Q4, and for the full year, when combined with our services business, they represent over 53% of revenue, clearly highlighting the success of our continued business transformation.

In addition to delivering strong financial results, our innovation engine continues to accelerate. Over the last year, we introduced an impressive number of new capabilities across our entire portfolio while also doubling down on more flexible consumption models, including our core networking capabilities as a service, highlighted by the recent launch of Cisco Plus.

Our new Cisco Plus solutions deliver cross-portfolio technologies to help solve our customers biggest needs with faster time to value. Our initial Network-as-a-service offerings deliver hybrid cloud technologies and will later expand to a broader catalog of services built and delivered with our partner ecosystem. Cisco Plus improves speed, agility and scale with on-demand solutions that intelligently adapt to our customers' business needs. While still early days in its launch, Cisco Plus directly aligns with our transformation goals around driving more subscription-based recurring revenue via the cloud.

Our unique strengths and proven strategy give us the confidence to move at a more accelerated pace. You will see us continue to invest in our key growth areas and technology shifts like hybrid cloud, hybrid work, 5G, WiFi6, edge, security, and cloud-native architectures to extend our technology leadership positions.

You will also see us deliver even more strategic offers to enable our customers to thrive in a cloud-first digital world. These include Full Stack Observability to improve their digital experiences by providing visibility and insights across their entire technology stack and Secure Access Services Edge, or SASE, designed to enable seamless, secure access to applications anywhere their users work.

Given the momentum we're seeing in our business, we have more conviction than ever that we are investing in the right areas and will continue to extend our competitive advantages and drive growth.

Before I turn it over to Scott for more details on the quarter and our expectations for the next fiscal year, let me give you an update on the supply environment.

While we are seeing increasing demand for our technology, we are also continuing to manage through the components shortage challenges that nearly every company is experiencing. Our world-class supply chain team, as always, is doing an incredible job navigating this complex situation by working with our global suppliers to meet customer demand as quickly as possible. Looking ahead, we expect the supply challenges and cost impacts to continue through at least the first half of our fiscal year and potentially into the second half.

In summary, demand for our technology is very strong, and our strategy is more relevant than ever. This allows us to deliver greater value to our customers, partners and communities as we all adapt to new ways of living and working.

I am very encouraged by the recovery trajectory across the board and with our momentum. I am confident in our strategy and investments. I feel great about the innovation we are driving in our portfolio, and I'm incredibly proud of what our teams and partners have achieved.
I look forward to building on these insights with a more comprehensive, deep dive on our multi-year vision and strategic growth drivers at our Virtual Investor Day on September 15th, and I hope you'll join us.

Thank you again for your time. And with that, I'll turn it over to Scott for additional detail.

Financial Overview

Thanks, Chuck. Our fourth quarter reflects a strong close to our fiscal year with significant momentum across our business. We saw robust customer demand, demonstrating the third consecutive increase in product order growth and solid execution by our teams.

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

Q4 was a very strong quarter and a very dynamic environment. We executed exceptionally well, with greater than 30% product order growth year-on-year and more than 17% order growth versus our pre-COVID Q4 fiscal '19 product bookings, driven by strength across our portfolio. In fact, it was the strongest product order growth rate in over a decade. We also had strong results across revenue, net income, earnings per share, and as Chuck said earlier, record operating cash flows.

Total revenue increased to $13.1 billion, up 8% year-over-year, coming in at the high end of our guidance range for the quarter. We saw strength in a number of product areas and across all geographies. Our business continued to recover well and build momentum with sequential revenue growth of 3%.

Our non-GAAP operating margin was 33.5%, up 50 basis points. Non-GAAP net income was $3.6 billion and non-GAAP earnings per share was $0.84, both up 5% year-over-year and exceeding the high end of our guidance range.

Now let me turn to provide more detail on our Q4 revenue.

Total product revenue was $9.7 billion, up 10%. Service revenue was $3.4 billion, up 3%.

Infrastructure Platforms performed very well with revenues up 13%. All businesses saw double-digit growth, with the exception of Data Center. Switching had strong growth, driven by double-digit increase in Campus Switching, led by our Catalyst 9K and Meraki switching offerings. We also had solid growth in our Data Center switching portfolio with the Nexus 9K products. Routing grew, driven by both the service provider and enterprise markets, as we saw strong adoption across our portfolio, including robust uptake of our Cisco 8000 platform. Wireless had strong growth, driven by the continued ramp of our WiFi6 products and our Meraki wireless offerings. Data Center revenue declined, driven primarily by servers, as we experienced continued market contraction.

Applications were down 1%, driven by a slight decline in our collaboration portfolio; however, recurring subscription revenue within our Webex Suite grew 9% in Q4. We also saw solid growth in IoT software, App Dynamics, cloud contact center and our cloud calling platforms.

Security was up 1%; our cloud security and Zero Trust portfolios performed well, with greater than 20% growth, as we had continued momentum in our Duo and Umbrella offerings. Our Security recurring subscription revenue grew 13% in Q4 and 18% for the full fiscal year. In both Applications and Security, we are seeing strong revenue growth in the strategic areas that we and our customers are investing in.

We continued to transform our business, delivering more software offerings and driving growth in subscriptions and recurring revenue. Software revenue was $4 billion, an increase of 6%; subscriptions were 81% of total software revenue, up 3 points year-over-year. Software subscription revenue grew 9% in Q4 and 15% for the full fiscal year. As we continue to increase our software subscriptions, we're driving higher levels of recurring revenue.

Additionally, the strength of our portfolio and transition to more software and services is driving growth in remaining performance obligations, or RPO. At the end of Q4, RPO crossed the $30-billion mark at $30.9 billion, up 9%. RPO for product was up 18% and service was up 3%. Approximately 53% of the total RPO is short-term, meaning it will be recognized as revenue in the next 12 months.

As I mentioned, we had exceptionally strong order momentum in Q4 as total product orders were up 31% with strength across the business. Looking at our geographies, the Americas was up 34%, EMEA was up 24% and APJC was up 29%. Total Emerging Markets were up 25%, with the BRICs plus Mexico up 37%. In our customer segments, Commercial was up 41%, Service Provider was up 40%, Enterprise returned to growth and was up 25%, while Public Sector was up 22%.

Non-GAAP total gross margins came in at 65.6%, up 60 basis points year-over-year. Product gross margin was 65%, up 180 basis points, and Services gross margin was 67.4%, down 240 basis points, which was in line with our expectations as we do see variability from quarter to quarter. The increase in product gross margin was driven by productivity improvements from lower freight and other costs, partially offset by relatively modest price erosion.

As we discussed last quarter, we continue to manage through the supply chain constraints seen industry-wide due to components shortages. We have closely partnered with our key suppliers, leveraging our volume purchasing and extended supply commitments as we address the supply challenges and cost impacts which we expect will continue at least through the first half of our fiscal year and potentially into the second half. Our #1-ranked global supply chain team continues to perform at a world-class level.

When you look at the impact of acquisitions on our Q4 results year-over-year, there was a positive 210-basis-point impact on revenue and no material impact on our non-GAAP earnings per share.

From a cash perspective, operating cash flow for the quarter was a record $4.5 billion, up 18% year-over-year, driven by strong cash collections.

We ended Q4 with total cash, cash equivalents and investments of $24.5 billion, up approximately $900 million sequentially.

In terms of capital allocation, we returned $2.4 billion to shareholders during the quarter that was comprised of $1.6 billion for our quarterly cash dividend and $791 million of share repurchases.

We continue to invest organically and inorganically in our innovation pipeline. During Q4, we closed five acquisitions: Kenna Security, Socio Labs, Slido, Sedona Systems and Involvio. These investments are consistent with our strategy of complementing our internal innovation and R&D with targeted M&A to allow us to further strengthen and differentiate our market position and our key growth areas.

Turning to the full fiscal year results. Overall, our financial results were solid in a very challenging global pandemic environment, with strong operational execution. Revenue was $49.8 billion, up 1%; total non-GAAP gross margin was 66.1%, up 10 basis points; and our non-GAAP operating margin was 33.5%, down 30 basis points. From a bottom line perspective, our non-GAAP net income was flat at $13.6 billion and non-GAAP earnings per share was $3.22. We delivered operating cash flow of $15.5 billion, flat compared to fiscal '20.

From a cap allocation perspective, we returned $9.1 billion in value to shareholders over the fiscal year, which represents 61% of our free cash flow. That was comprised of $6.2 billion in quarterly cash dividends and $2.9 billion of share repurchases. We also increased our dividend for the 10th consecutive year in fiscal 2021, reinforcing our commitment to return capital to our shareholders and our confidence in the strength and stability of our ongoing cash flows. We remain firmly committed to maintaining a strong balance sheet to fuel our organic and inorganic growth initiatives, as well as continuing our cap allocation strategy of returning a minimum of 50% of our free cash flow to shareholders annually.

To summarize, we had a great Q4 and a solid fiscal year, with strong operational execution. We're seeing returns on the investments we're making in innovation and driving the continued shift to more software and subscriptions, driving more recurring revenue, delivering growth and driving shareholder value.

Guidance

Now let me provide our forward-looking guidance. We are pleased to initiate the additional practice of providing an annual outlook to complement our regular quarterly look ahead for fiscal year 2022. The successful transformation we've been executing around driving a higher proportion of our revenues from subscriptions, recurring and deferred revenue is affording us additional visibility into our outlook for future growth. Please note our guidance is subject to the disclaimer regarding forward-looking information that Marilyn referred to earlier.

Our financial guidance for Q1 is as follows:
We expect revenue growth to be in the range of 7.5% to 9.5% year-on-year.

We anticipate the non-GAAP gross margin to be in the range of 63.5% to 64.5%, reflecting the continuing increase in supply chain costs we are incurring as we protect shipments to our customers.

Our non-GAAP operating margin is expected to be in the range of 31.5% to 32.5%.

Non-GAAP earnings per share is expected to range from $0.79 to $0.81.

Our financial guidance for the full year fiscal '22 is as follows:

We expect revenue growth to be in the range of 5% to 7% year-on-year.

Non-GAAP earnings per share is expected to range from $3.38 to $3.45, also up 5% to 7% year-on-year.

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

Looking ahead, we're excited to host a virtual Cisco Investor Day on Wednesday, September 15, 2021, which we will webcast live, and hope you can join us.

<u>Summary Comments</u>

So I'm really proud of our team. I'm really proud of the performance, and we're certainly pleased with the demand that we've seen. I'm super happy with the transformation; we believe our investments are paying off, our software business, the work we're doing with the webscale and the cloud providers, and across the portfolio.

I think our technology will help our customers deal with this emerging focus on resiliency and agility and adaptability, and then most of all, I want to thank our teams for the incredible execution, not only in Q4 but over the last 12 to 18 months during a very complicated time, and I'd like to also just remind you and encourage you all to join us on September 15th for the Investor Day. Thank you.

<u>Closing</u>

Thanks, Chuck. Cisco's next quarterly earnings conference call, which will reflect our fiscal 2022 first quarter results, will be on Wednesday, November 17, 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 will now plan to close the call. If you have any further questions, feel free to contact the Cisco investor relations group, and we thank you all 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 the continued momentum in our business, the demand for our technology, our ability to help the acceleration of our customers' digital transformation, and the continuation of our business model transformation to more recurring revenue) and the future financial performance of Cisco (including the guidance for Q1 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 infrastructure platforms 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, 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; 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, 2021, and September 3, 2020, 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 31, 2021 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.